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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

Postal Rate and Fee Changes **Docket No. R2006-1**

DIRECT TESTIMONY OF RICHARD E. BENTLEY ON BEHALF OF MAJOR MAILERS ASSOCIATION DST MAILING SERVICES, INC. AND ASSOCIATION FOR MAIL ELECTRONIC ENHANCEMENT, INC.

September 6, 2006

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Direct Testimony of Richard E. Bentley
On Behalf of
Major Mailers Association

I. INTRODUCTION

A. Statement of Qualifications

My name is Richard E. Bentley. I am currently a self-employed consultant with an expertise in postal ratemaking. My business address is REB Consulting, 9133 Ermantrude Court, Vienna VA 22182.

I began my career as a market research analyst for the Postal Rate Commission in 1973 and remained there until 1979. As a member of the Officer of the Commission's technical staff (now the Office of Consumer Advocate), I testified before the Postal Rate Commission in four separate proceedings. Since leaving the Commission, I have testified before the Commission as a private consultant in every major rate case, most recently in Docket No. R2001-1, and the most recent major reclassification case, Docket No. MC95-1. I also represented MMA and took part in the last omnibus rate case, Docket No. R2005-1, although I did not file testimony. A more detailed account of my 30 plus years of experience as an expert witness on postal ratemaking and classification is provided as Attachment I to this testimony.

I worked for Systems Consultants, Inc. from 1979 until 1981 as a senior program engineer on projects concerning our nation's defense. From 1982 until 2005 I was President of Marketing Designs, Inc. Marketing Designs provided specialized marketing services to retail, commercial, and industrial concerns, as well as consulting services to a select group of private clients until its closing late last year.

I received a Bachelor of Science degree in Industrial Engineering/Operations Research from Cornell University in 1972. The following year I was awarded a Master's degree In Business Administration from Cornell's

Graduate School of Business and Public Administration. I am a member of Tau Beta Pi and Alpha Pi Mu engineering honor societies.

B. Purpose of Testimony

I am submitting testimony on behalf of Major Mailers Association (MMA), a group of very large First-Class workshared mailers that generally send out account statements and invoices on their own behalf or on behalf of others. MMA, has asked me to evaluate the Postal Service's proposed First-Class workshared mail rates in view of applicable statutory ratemaking criteria and relevant Commission decisions.

There are three areas of particular concern and importance to MMA: the rates and discounts applicable to workshared letters weighing one ounce or less, the rates for additional ounces, and establishment of shape based rates within First Class. Justification of First-Class bulk discounts is directly related to the Postal Service's proposal to "de-link" the rates for First-Class single piece and workshared rate categories. The other two First-Class issues concern the establishment of rates that better reflect cost causation.

In addition, MMA asked me to examine issues relating to the design of rates for High Volume QBRM and Confirm Service.

C. Summary of Testimony

My testimony discusses each of the rate proposals that impact large First-Class mailers. The most important issue concerns the long-run viability of workshared discounts. I support the specific workshared rates proposed by the Postal Service and applaud the Postal Service for seeking a more rational, less controversial approach to determine First Class workshared mail rates. While I have some reservations about how well the Postal Service's de-linking proposal will work in the long term, my analysis of the recent historical relationships between the rates for First Class single piece and Presort mail indicate that First Class rates based on the Postal Service's principles of de-linking exhibit a reasonable degree of stability that is likely to continue for the foreseeable future.

As a further “check” on the reasonableness of the specific workshared mail rates that are proposed using the Postal Service’s de-linking methodology, I have also used the Commission’s traditional methods for evaluating discounts based on derived cost savings. More specifically, I derive mail processing and delivery unit costs for each presort category and compare them to the corresponding unit cost for a nonworkshared benchmark mail piece. Accordingly, I find that the specific First-Class workshared mail rates proposed in this case are well supported, regardless of whether the Commission adopts the de-linking approach as I recommend, or sets discounts and rates based on a traditional cost savings approach.

In the course of examining the Postal Service’s rate filing, I discovered significant attributable cost shifts into First-Class presort letters between FY 2004 and BY 2005. MMA is very concerned about this apparent cost shift because it has not been adequately explained or justified by the Postal Service. Intuitively, the costs of processing and delivering First Class workshared mail should, if anything, increase less than the costs for single piece mail, especially in light of the Postal Service’s efforts to shift additional worksharing tasks onto workshared mailers in general and high volume workshared mailers in particular. Such trends should reduce postal costs, not increase them as the Postal Service’s cost pool data shows.

I endorse the Postal Service’s proposal to provide a new First-Class rate structure that better reflects cost causation. I urge the Commission to accept the new shape-based rates for First-Class single piece and bulk and the concomitant lower additional ounce rates. Both proposals serve to reduce intra-class subsidies and bring revenues and costs much more in line with each other than ever before. As such, they represent a welcome improvement over the existing rate structure.

I have also reviewed the Postal Services proposals that impact QBRM. I strongly urge the Commission to reject the Postal Service’s proposed 22% reduction in the current QBRM discount. The Postal Service bases its proposal on a flawed and artificially narrow cost savings analysis that improperly

understates QBRM cost savings by more than 5 full cents. I recommend that the discount be increased to at least 4 cents. Similarly, the Commission should reject the Postal Service's proposal to increase the High Volume QBRM per piece fee, from 0.8 cents to 0.9 cents based on a new BRM Practices Study that suffers from the same problems associated with the 1997 BRM Practices Study. More reasonable and reliable information regarding procedures for counting High Volume QBRM leads me to conclude that the per piece fee should be reduced to 0.5 cents or eliminated entirely.

Finally, the Postal Service proposes to completely overhaul the fee structure for Confirm Service. Currently, Confirm subscribers have a choice of three subscription levels, Silver, Gold, and Platinum. A Platinum Confirm subscriber pays $10,000 per year and obtains information on an unlimited number of letter scans. The Postal Service proposes to eliminate the category that allows for unlimited scans and charge subscribers based on the number of scans they need.

Due to the shared benefits that mailers and the Postal Service derive from Confirm Service, the Commission should consider eliminating the usage fee altogether and make Confirm Service available at no extra charge (except for an annual account maintenance charge) as part of the Postal Service's premier First-Class service. In the alternative, I urge the Commission to reject the Postal service's proposed 49% revenue increase as well as changes to the fee structure. The current three tier fee structure, including the category of unlimited of scans, should be maintained.

D. Guide to Testimony and Supporting Documents

As part of my testimony I am sponsoring three Category 2 library references which support the worksharing costs analyses presented for First-Class workshared letters. Library Reference MMA-LR-1 derives unit mail processing cost savings and combines these savings with the unit delivery cost savings that are derived separately in Library Reference MMA-LR-2. Library Reference MMA-LR-3 provides support for my conclusion that the Postal

Service's mail flow models significantly understate mail processing costs associated with the Remote Bar Code System (RBCS).

There are also two technical appendices attached to this testimony. Appendix I provides a technical discussion of my analysis that uses traditional methods for estimating cost savings that result from worksharing. Appendix II discusses issues related to the estimation of QBRM cost savings and derivation of the High Volume per piece cost.

In addition, I have two sets of workpapers. Workpaper MMA WP-1 consists of historical postal data from which I have drawn some general conclusions about the manner in which costs behave. Workpaper MMA WP-2 provides an analysis of QBRM costs under certain assumptions.

II. SUPPORT FOR USPS PROPOSED FIRST-CLASS WORKSHARED DISCOUNTS

In this case, the Postal Service proposes to increase the basic First-Class rate by 3 cents and to increase discounts by moderate amounts as shown in Table 1.

Table 1
USPS Proposed Workshared Discounts For Letters
(Cents)

First Class Workshared Letter Category	Current Discount	Proposed Discount	Proposed Increase
NonAutomation	1.9	2.0	0.1
Mixed AADC	6.4	7.4	1.0
AADC	7.3	8.5	1.2
3-Digit	8.2	8.9	0.7
5-Digit	9.7	10.8	1.1
Carrier Route	10.0	10.8	0.8

The proposed discounts represent an average increase of 10.3% coupled with an absolute increase in rates of 6.4%. Given the extremely high implicit cost

coverage for First-Class workshared mail, an average increase that is somewhat below the 8.5% overall average is warranted.

A. USPS "De-Link" Proposal

1. De-Link Description

USPS witness Taufique explains in detail his new and innovative proposal to "de-link" First-Class workshared rates and discounts from First-Class single piece. This potentially ends a decade-long conflict that has seen the Postal Service, intervenors and the Commission disagree on almost all aspects of the "method" for measuring workshared cost savings. Certainly, the Postal Service's ongoing attempts since R97-1 to "refine" its workshared costs savings methodology in a manner that always seems to reduce derived cost savings have exacerbated the situation.[1] The de-link proposal is a welcome relief from the considerable controversy generated in recent omnibus rate cases. I applaud the Postal Service for bringing this long and unduly complicated conflict to an end.

USPS witness Taufique's de-link proposal consists of two parts. First, workshared discounts are to be determined by market-based factors as well as the derived ***relative*** cost differences among the various presort levels. Second, the Postal Service intends to establish a goal of equal unit contributions to institutional costs from First-Class single piece and First-Class Presort, in the aggregate.

There is no doubt that de-linking First-Class workshared discounts from derived cost savings greatly simplifies the Postal Service's workshared rate/discount presentation. This alone is a significant benefit and encourages me to embrace the de-linking concept. It should also put an end to the Postal

[1] Recent attempts to reduce derived cost savings that were either rejected outright or partially by the Commission, or not addressed because of settlements, include: (1) assuming cost variability is much less than 100% (first introduced in R97-1), (2) assuming zero cancellation costs for BMM while leaving in cancellation costs for Automation letters (R2000-1), (3) assuming certain cost pools such as platform costs are nonworkshared-related (R2000-1), and (4) using a subcategory of Nonautomation letters as the benchmark from which to measure delivery costs savings (R2001-1).

Service's unenviable tactic of proposing discounts that ***appear*** to be greater than the estimated cost savings. Since R97-1, Postal Service costing witnesses have consistently understated workshared cost savings to such an extent that its rate witnesses were forced to disregard the cost analysis in favor of demand and market-based factors.

The de-linking of rates from derived cost savings also eliminates the inherent problems associated with mail flow models that attempt to compare unit costs on an ***absolute*** basis. Since R2000-1, the models have failed to accurately reflect the CRA-derived unit cost standards.[2] I have already testified about my reservations about using the models to measure cost savings, specifically savings that accrue because workshared letters bypass the Remote Bar Code System (RBCS) while nonworkshared letters do not.[3] Under the new proposal, the models no longer attempt to measure workshared cost savings from a nonworkshared benchmark, but are used only to derive the ***relative*** unit costs for each presort level. This solves one of the major criticisms I have with the Postal Service's use of its mail flow models.

The serious limitations of the mail flow models, particularly as they relate to costs incurred by the benchmark category within the RBCS, have greatly limited the usefulness of the models.[4] As demonstrated in Library Reference MMA-LR-3, the RBCS processing costs as reflected by the mail flow models are far too efficient. For example, when the metered mail letter (MML) model is adjusted such that 100% of the letters are assumed to be prebarcoded, the model-derived unit costs ***increase*** when they certainly ***should decrease***.

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[2] The models for Automation letters have always overstated the CRA-derived costs, while the models for BMM have always understated the CRA-derived benchmark. Since BMM must be processed through the Remote Bar Code System (RBCS), I have concluded that one conspicuous drawback of the models is an inability to accurately reflect costs associated with the RBCS.

[3] My R2001 surrebuttal testimony discussed this phenomenon at length when unit costs for letters that required RBCS processing (hand-addressed letters) and letters that bypassed the RBCS (QBRM) were derived and compared. *See* KE-ST-1, pages 7 – 17.

[4] Application of CRA Proportional Adjustment factors tends to correct for this deficiency, but problems still persist. The Postal Service's failure to recognize that its models understate RBCS costs causes it to misapply its CRA Proportional Adjustment factors, resulting in an understatement of the costs to process Nonautomation letters and an overstatement of the costs to process QBRM.

Accordingly, I urge the Commission to seriously consider developing First-Class workshared discounts that are no longer tied to a theoretical single piece benchmark.

The second aspect of the proposal to de-link rates and costs is a bit more problematic. The aim of equal contributions to institutional costs is simple to execute but lacks a degree of relevance. On the one hand, such a proposal tends to maintain the First-Class single piece/presort overall rate relationship through a fairly stable standard that reflects the combined attributes of several rate categories. In other words, the unit contributions in aggregate from both First-Class single piece and presort mail will be highly resistant to small year-to-year changes in cost-causing attributes. Certainly the vast volumes that reach nearly 100 billion pieces will act to cushion such changes. The unit contributions have been stable since at least FY 2000 (Tr. 16/4824) and are likely to remain so for the foreseeable future. Accordingly, to maintain the current rate relationship between First-Class single piece and presort, the Postal Service's equal contribution addendum is likely to achieve reasonable results, at least for the short term.

On the other hand, I have some reservations regarding the relevance of equal contributions ***in the aggregate*** from each of the First-Class categories. Given the significant differences in the mail characteristics that constitute the two categories, as well as certain cost components that are reflected but have no relevance to worksharing, I am concerned about how changes in factors such as shape and weight can modify this relationship over the long run. Consequently, I suspect that a comparison of contributions between similar shapes might prove to be a better means for setting the absolute level of workshared discounts from the First-Class single piece letter standard.

2. De-Link Implementation

Under the Postal Service's de-link proposal, the proposed discounts reflect the cost differences between each of the presort levels. However, the Postal Service's costing evidence improperly disregards important cost differences. Accordingly, I have made reasonable modifications to USPS witness

Abdirahman's mail flow cost models and USPS witness Kelley's delivery cost analysis. Those modifications are explained in Technical Appendix I to my testimony.

Following USPS witness Taufique's lead of using Mixed AADC letters (MAADC) as the benchmark, I have computed unit costs and unit cost differences in the same manner as he has done. *See* USPS-T-32 at 29-30. Table 2 reproduces Mr. Taufique's computations and compares the incremental percent passthroughs under both methods. Based on the percent passthroughs that are well under 100%, it is apparent that my method of deriving cost savings provides even more support for the USPS proposed discounts than the Postal Service's methodology.

Table 2
Comparison of MMA and USPS Incremental Percent Passthroughs Under De-Linking[5]
(Cents)

First Class Workshared Category	USPS Proposed Discount	USPS Proposed Incremental Discount	TY 2008 Total Workshared Unit Cost*	Incremental Unit Cost Savings	Incremental % Passthrough
MMA					
Auto Mixed AADC	7.4		12.17		
Auto AADC	8.5	1.1	10.22	1.95	57%
Auto 3-Digit Letters	8.9	0.4	9.53	0.70	58%
Auto 5-Digit Letters	10.8	1.9	7.30	2.22	85%
USPS					
Auto Mixed AADC	7.4		6.47		
Auto AADC	8.5	1.1	5.32	1.15	96%
Auto 3-Digit Letters	8.9	0.4	4.93	0.40	100%
Auto 5-Digit Letters	10.8	1.9	3.63	1.30	146%

*Includes mail processing plus delivery for MMA, just mail processing for the Postal Service
Sources: MMA-LR-1, p. 1, USPS-LR-L-48, p. 1

[5] I note that certain computations shown in this table, as well as other tables in this testimony and appendices, may not be exact due to rounding.

Differences between MMA's unit workshared costs and those of the Postal Service, as shown in Table 2, are attributable to the following methodological changes:

- ✓ Use of the PRC attributable costs (instead of the Postal Service's attributable costs)
- ✓ Re-classification of certain nonmodeled unit cost pools as proportional with respect to presort level (instead of fixed)
- ✓ Application of separate CRA Proportional Adjustment factors for Automation and Nonautomation (rather than one factor)
- ✓ Inclusion of delivery cost savings (rather than assuming none exist)

B. Traditional Method for Measuring Workshared Cost Savings

Using traditional methods for deriving workshare cost savings for First-Class letters, I confirm that the Postal Service's proposed discounts are justified. The standard yardstick for such an analysis is a comparison of the derived cost savings to the proposed discount amount, which computes to a percent passthough. A reasonable goal for computing percent passthroughs is that they should be less than 100%. This indicates that both the Postal Service and mailers enjoy the benefits of worksharing. Percent passthroughs of more than 100% are acceptable under certain conditions but are often temporary and viewed with caution.

The results of my analysis, with the computed percent passthroughs of the derived cost savings, are shown below in Table 3.

Table 3
Comparison of USPS Proposed Discounts and MMA Derived
TY 2008 Cost Savings Using Traditional Methods
(Cents)

First Class Workshared Category	USPS Proposed Discount	MMA Derived Unit Cost Savings	Total % Passthrough	USPS Proposed Incremental Discount	MMA Derived Incremental Unit Cost Savings	Incremental % Passthrough
NonAutomation	2.0	2.9	70%	2.0	2.9	70%
Auto Mixed AADC	7.4	8.5	87%	5.4	5.6	96%
Auto AADC	8.5	10.5	81%	1.1	1.9	57%
Auto 3-Digit Letters	8.9	11.1	80%	0.4	0.7	58%
Auto 5-Digit Letters	10.8	13.4	81%	1.9	2.2	85%
Auto CR Letters	10.8	13.4	81%	1.9	2.2	85%

Source: MMA-LR-1, page 1

As shown in Table 3, the percent passthroughs can be computed two ways: (1) in total amounts from the single piece benchmark, and (2) incrementally from each succeeding rate category. In both situations, the discounts proposed by the Postal Service are lower than the derived cost savings and the percent passthroughs are less than 100%.

It is important to note that the specific discounts proposed by the Postal Service might not be optimal insofar as obtaining the most equitable percent passthroughs. For example, it could be considered more desirable to propose discounts that result in equal percent passthroughs. However, there are demand and market-based factors that need to be considered and I have decided to forego tinkering with small rate changes that could upset the break-even equilibrium that the Postal Service has worked so hard to achieve in this case.

C. Derivation of Workshared Unit Cost Savings for First-Class Letters

There are two parts to the derivation of workshared unit cost savings: mail processing and delivery. Table 4 shows the methodology I use as a check on the reasonableness of the results produced by the Postal Service's de-linking proposal in this case and compares it to the method approved by the Commission in R2000-1, the last litigated rate case. The table also compares MMA's methodology to positions taken by the USPS in R2001-1 and R2005-1, both of which were settled, and in R2006-1. I have color coded the table to indicate where methods are consistent with the Commission's analysis in R2000-1 (yellow) and where MMA's method includes adoption of an element of the Postal Service's methods (green).

1. Mail Processing Operations

The derivation of cost savings that result from worksharing is a complex undertaking. I begin with the Postal Service's analysis presented in Library Reference USPS-LR-L-110, which replicates USPS witness Abdirahman's workshared cost savings analysis using the Commission's attributable cost methodology. Based on that analysis, I make several changes that I believe are necessary in order to achieve reliable and reasonable results. The analysis of mail processing worksharing cost savings is provided in Library Reference MMA-LR-1.

Table 4
Comparison Of Workshared Cost Savings Analyses

Issue	MMA R2006-1	PRC R2000-1	USPS R2001-1 and R2005-1	USPS R2006-1
Mail Processing:				
Costs Benchmark	PRC Attributable Costs MML	PRC Attributable Costs Adjusted MML	USPS Attributable Costs MML	USPS Attributable Costs NA
Cost Pool Classification	Worksharing Proportional, Fixed	Worksharing Proportional, Fixed and Nonworksharing Fixed	Worksharing Proportional, Fixed and Nonworksharing Fixed	Worksharing Proportional, Fixed
Automation & NonAuto Costs	Combined from CRA and Modeled to Separate	Taken Directly from CRA and Separately Modeled	Taken Directly from CRA and Separately Modeled	Combined from CRA and Modeled to Separate
CRA Proportional Adjustment Factor	Applied Separately for BMM, Auto and NonAuto letters	Applied Separately for BMM, Auto and NonAuto letters	Applied Separately for BMM, Auto and NonAuto letters	Derived and Applied for all Presorted Letters Combined, NA for BMM
DPS %s Derivation	Derived Separately for Auto and NonAuto Letters from Models	Derived Separately for Auto and NonAuto Letters from Models	Derived Separately for Auto and NonAuto Letters from Models	Derived Separately for Auto and NonAuto Letters from Delivery Data
DPS %s Reconciliation	Reconciled to Delivery Data	Not Reconciled	Not Reconciled	Reconciled to Delivery Data
Delivery:				
Benchmark	Single Piece Letters	NonAuto Letters	NonAuto Machinable Mixed AADC Letters	NA
Presort Categories	Unit Delivery Costs Derived Separately for Each Presort Level	Unit Delivery Costs Derived Separately for Each Presort Level	Unit Delivery Costs Derived Separately for Each Presort Level	Unit Delivery Cost Derived for All Auto Letters Combined

As shown in Table 4 above, I have made certain necessary modifications to the Commission's latest approved methodology in R2000-1. These revisions, which are based on the Postal Service's proposed methodology in R2001-1 and R2005-1, and the Postal Service's proposed methodology in this case, concern the following specific areas:

- ✓ Benchmark
- ✓ Cost Pool Classifications
- ✓ De-averaging of Nonautomation and Automation Costs
- ✓ Derivation of CRA Proportional Adjustment Factors
- ✓ Delivery Point Sequencing Percentages

The cost savings methodology shown in Table 4 builds upon the methodological approach utilized by the Commission and the Postal Service. A detailed explanation and rationale for the methodology employed within each of the areas listed above is provided in Technical Appendix I to my testimony.

2. Delivery Operations

The Mail delivery operation is the second major source of workshare cost savings. Recognition that significant cost savings accrue in the delivery operations and, therefore, should be included in the workshare cost savings analysis has been an integral part of the Commission's methodology since R97-1.[6]

Library Reference USPS-LR-L-67, sponsored by USPS witness Kelley, derives unit delivery costs by subclass and shape. This analysis confirms the fact that worksharing reduces delivery costs. Table 5 summarizes the Postal Service's unit delivery costs for First-Class letters. It shows the delivery cost savings for Nonautomation and Automation letters, and the cost savings for those two categories combined, which is what the Postal Service now calls "Presort."

[6] Starting in R2001-1, however, the Postal Service introduced a new wrinkle that essentially nullified all workshared cost savings that result from delivery. The Commission never ruled on this proposal because the case was settled, as was R2005-1.

Table 5
USPS TY 2008 Delivery Unit Costs And Workshared Cost Savings
(Cents)

First-Class Letter Category	(1) Unit Delivery Cost Per Orig Pc Without Collection	(2) Unit Delivery Cost Without Collection Per Delivered Pc	(3) Unit Delivery Cost Savings Per Delivered Piece	(4) Unit Delivery Cost Savings Per Orig Pc
Single Piece	5.15	8.42		
Nonautomation	4.70	5.24	3.18	2.85
Automation	4.14	4.63	3.80	3.40
Presorted	4.16	4.65	3.77	3.38

Source: MMA-LR-2, pages 1 and 2, Response to MMA/USPS-T30-31 (Tr. 12/3507)-8

The information provided in Table 5 is quite revealing. Column (1) shows the Postal Service's derived delivery unit costs per originating piece, with single piece collection costs removed. Since about 60% of single piece letters are actually delivered by city and rural carriers, while about 90% of presorted letters are actually delivered, a direct comparison of the unit costs in Column (1) would be skewed and inaccurate. Accordingly, Column (2) shows the unit delivery costs per ***delivered*** piece. The unit costs in Column (2) can be compared in a meaningful way because they are all based on volumes actually delivered. Column (3) shows delivery unit cost savings per delivered piece between workshared letters and nonworkshared letters. From the data shown, it is apparent that single piece letters cost 3.18 cents more to deliver than Nonautomation letters and 3.80 cents more to deliver than Automation letters.

Since the workshared discounts apply to all workshared volumes (including those that are not delivered), it is necessary to spread the unit cost savings shown in Column (3) over all workshared volumes. To do this, the unit cost savings in Column (3) are multiplied by the percentage of workshared letters that are actually delivered. The results are shown in Column (4).

There can be no argument that Postal Service data indicate that Presorted letters cost, on average, 3.38 cents less to deliver than single piece letters.[7]

My analysis of delivery costs takes the Postal Service's data one step further. Rather than evaluate the costs for all single piece letters and all Automation letters, I have de-averaged single piece letters into three indicia categories – stamped, metered and "other," and have de-averaged Automation letters into the four presort level components – MAADC, AADC, 3-digit and 5-digit. A full discussion of how this was accomplished is provided in Technical Appendix I. The resulting delivery cost savings are shown in Table 6.

Table 6
Summary of TY 2008 Workshared Letters Delivery Cost Savings
(Cents)

First-Class Letter Rate Category	Delivery Unit Cost Savings	Incremental Unit Cost Savings
Nonautomation Presort Letters	2.85	2.85
Automation MAADC Presort Letters	3.09	0.24
Automation AADC Presort Letters	3.26	0.17
Automation 3-Digit Presort Letters	3.34	0.08
Automation 5-Digit Presort Letters	3.54	0.20
All Automation	3.40	3.40
All Presorted	3.38	3.38

Source: MMA-LR-2, p. 1

[7] The bottom line reason for this, as illustrated by Postal Service data, is that 85.0% of presorted letters can be DPSed while only 71.5% of single piece can be DPSed. *See* Library Reference USPS-LR-L-48, Tr. 12/3358. The ability for letters to be DPSed is the result of two factors: mail piece design consistent with automation compatibility and the probability that a letter is accepted by automation equipment throughout the mailstream. The vast majority of presorted letters pay Automation rates, which must meet very stringent automation compatibility requirements. Presorting allows mails to enter the mailstream at later points, increasing the probability that letters can be accepted by automation equipment. Consequently, there should be no surprise that worksharing, by definition, has such a significant impact on reducing delivery costs.

III. USPS AND MMA RELATIVE WORKSHARED COST SAVINGS COMPARED

Table 7 compares the Postal Service's and MMA's proposed unit cost differences among the First-Class presort letter categories. This table uses Nonautomation letters as the benchmark for ease of comparison under the de-link proposal. Note also that unit costs include both mail processing and delivery cost differences and reflect different attributable cost methodologies.

Table 7
Comparison of First-Class Presort Letter TY 2008 Unit Cost Differences (Cents)

	USPS (USPS Cost Method)			MMA (PRC Cost Method)		
First-Class Presort Letter Category	**MP & Del Unit Cost Per Originating Piece**	**Total Unit Cost Savings**	**Incremental Unit Cost Savings**	**MP & Del Unit Cost Per Originating Piece**	**Total Unit Cost Savings**	**Incremental Unit Cost Savings**
Nonautomation	11.00			17.80		
Mixed AADC	10.61	0.38	0.38	12.17	5.63	5.63
AADC	9.47	1.53	1.15	10.22	7.58	1.95
3-Digit	9.07	1.93	0.40	9.53	8.27	0.70
5-Digit	7.77	3.23	1.30	7.30	10.49	2.22

Sources: USPS-LR-48, p. 1, USPS-LR-67, p. 1 and MMA-LR-1, p. 1 and MMA-LR-2, page 1

Table 7 illustrates several interesting results that are worth emphasizing. First, there are significant differences between the savings reported for Nonautomation letters. As discussed above and more fully in Technical Appendix I, the Postal Service's failure to recognize that its mail flow models understate costs for Nonautomation letters processed within the RBCS causes the Postal Service to understate the unit processing cost for that category. As Table 7 shows, the Postal Service's cost savings for Mixed AADC letters compared to Nonautomation letters is only 0.38 cents. My calculations show a savings of 5.63 cents. In other words, the Postal Service's underestimation of

Nonautomation costs erroneously reduces the cost savings between Nonautomation and MAADC letters by more than 5 cents.[8]

Second, the Postal Service's costs seem to indicate that Nonautomation and Automation MAADC letters exhibit very similar costs. In fact, a further breakdown of the unit cost differential amount of 0.38 cents shown above indicates that Nonautomation letters cost 0.17 cents less to process but 0.55 cents more to deliver. *See* Library References USPS-LR-48, p. 1 and USPS-LR-67, p. 1. While the delivery aspect of this comparison is reasonable, the lower mail processing costs shown by the Postal Service for Nonautomation letters is not. Considering the facts that volume shifts have considerably reduced the number of 3/5 digit presorted letters within the Nonautomation category[9] and that all Nonautomation letters have to be processed within the RBCS, it is difficult to accept the notion that Nonautomation letters could possibly cost less to process than Automation MAADC letters.

USPS witness Abdirahman opined that "cost savings from presortation may have offset the costs required to apply a barcode to the average nonautomation mail pieces." Tr. 4/547. I find his "explanation" highly unlikely simply because the RBCS is not as efficient as the models seem to predict. Moreover, no mailer strives to prepare its mail to obtain the 2-cent Nonautomation discount when Automation discounts are so much higher.[10] At least in the case of large mailers like MMA members, a small portion of their letters is sent out as Nonautomation primarily because a problem with the address prevents the software from applying a prebarcode. These problems make it difficult for the Postal Service to successfully apply a full 11-digit barcode that is necessary for the letters to be processed by automation and eventually DPSed. This could mean that some part of the address was missing, inaccurate,

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[8] This issue is explored in greater detail in my technical discussion of CRA Proportional Adjustment factors. See Technical Appendix I, pages 10-16.

[9] USPS witness Loetscher explains why Nonautomation volumes have become much less densely presorted over the past ten years. Tr. 7/1487.

[10] In order to qualify for Automation discounts, First Class workshared mailers are required to apply an 11-digit barcode to their letters. If that is not possible, no barcode is permitted and the letters default to the Nonautomation category.

or duplicated. As a result, such pieces have to be corrected by the Postal Service, which probably entails (1) processing through the REC system to obtain a barcode, (2) the application of a partial barcode (5-digit or 9-digit), and/or (3) manual processing. Nonautomation letters that cannot be properly barcoded will have to receive some manual processing, significantly raising the costs to process this mail.[11]

Finally, the unit cost savings shown in Table 7 indicate a significant difference in all of the incremental cost savings. USPS witness Taufique rejected a larger discount for 5-digit letters because the resulting incremental percent passthrough was 164%, a passthrough he was uncomfortable with. USPS-T-32 at 33. His final proposed rate resulted in a percent passthrough of 146%. As Table 7 shows, however, under MMA's methodology the 5-digit incremental cost savings is 2.2 cents, which, as shown in Table 3 above, results in a very reasonable incremental passthrough of only 85 %.

IV. OTHER ISSUES

There are several other issues that affect First-Class Presort mailers. These concern changes in the way that the In-Office Cost System (IOCS) collects and assigns tallies, shape-based rates proposed for First Class, First-Class additional ounce rates, QBRM rates, and fees for both QBRM and Confirm Service.

D. Data Collection Cost Shifts

In reviewing the cost data in this case and making routine comparisons to BY 2004 costs in R2005-1, it became apparent that First-Class presorted letters exhibited much higher cost increases than other classes and rate categories. As shown in Table 8, the increase in attributable costs for First-Class Presort letters is much higher than for First-Class single piece and Metered Mail (MML) letters.

[11] The higher DPS % exhibited by Automation MAADC letters (80.8%) compared to Nonautomation letters (77.2%) also supports this proposition. *See* Library Reference MMA-LR-1, p. 2.

Similarly, in Standard Mail, the attributable costs for Standard regular letters have actually decreased, while the costs for ECR have gone up significantly.

For First-Class presort letters, the impact of this irregular and counter intuitive cost behavior is two-fold. First, all other factors being equal, the higher increase for Presort letters relative to MML tends to reduce derived cost savings under the traditional cost savings approach discussed in Section II above. Second, increasing costs for Presort by a disproportionate amount artificially reduces the computed implicit cost coverage compared to previous of years. Both of these factors concern MMA, particularly because the Postal Service has provided no adequate explanation or justification for the disproportionate cost shifts. Parties such as MMA could not know that a shift of costs from First-Class single piece to presorted letters had occurred until the Postal Service admitted, late in the discovery process, that changes to the IOCS preclude a realistic comparison of BY 2005 costs in this case to those just one year earlier. Tr. 4/603-4; Tr. 9/2365-66.

Table 8 provides a comparison of the mail processing letter costs between BY 2004 and BY 2005.

Table 8
Comparison of Mail Processing Attributable Costs
(PRC Attributable Cost Methodology, Cents)

	PRC Attributable Costs		
Letter Rate Category	**FY 2004**	**FY 2005**	**Percent Increase**
Single Piece	13.35	13.61	2.0%
Metered Mail Letters	12.64	12.62	-0.2%
Presorted	4.50	4.77	6.2%
Standard Regular	4.52	4.13	-8.6%

Source: USPS-LR- K-99 L-99

As Table 8 shows, the percentage increase in attributable costs for First-Class presort rose more than three times the increase for First-Class single piece, while at the same time, MML costs decreased slightly and Standard

regular costs decreased by almost 9%. The Postal Service has explained that the reduction in Standard regular costs and concomitant increase in ECR costs was due to a change in IOCS data collection and assignment procedures intended to solve problems associated with misidentification of Standard regular and ECR mail pieces. In contrast, the Postal Service has provided no explanation for the significant shift of attributable costs to First-Class Presort. After propounding several interrogatories and receiving contradictory and ambiguous responses,[12] all we know is that the Postal Service claims that BY 2004 and BY 2005 costs cannot be compared because, "there was a change to the method used to collect and assign IOCS tallies." *See* e.g. Tr. 4/531. Moreover, the Postal Service is not willing to admit that the "actual" costs increased or decreased in the amounts shown in Table 8, and fails to provide any indication of what the "actual" cost changes are. Tr. __. (Responses to MMA/USPS-14(D), 15(E), 16(C), 17(C), and 19(D))

My analysis indicates that, but for IOCS redesign and assuming no shift from single piece to workshared letters, attributable costs for First-Class letters would have been lower by $146 million -- $39 million for single piece and $107 million for presorted letters. *See* Exhibit MMA-1A. This factor alone, which is totally independent of worksharing, nevertheless serves to reduce derived workshared costs savings simply because presorted letter costs increase much more (6.2%) in relation to the benchmark MML costs (-.2%).[13]

I urge the Commission to find out why the IOCS redesign impacted First-Class letters as shown and to make sure that the new forms and procedures have been properly implemented without some sort of bias, particularly against First-Class presort letters.

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[12] While failing to confirm MMA's derived cost increases between R2005-1 TY 2006 and R2006-1 TY 2008, the Postal Service claimed that MMA's computations were correct and that MMA's computations were the most accurate available. In addition, the Postal Service failed to provide its own calculations. See responses to interrogatories MMA/USPS-T22-2-4 (Tr. 4/529-541) and MMA/USPS-T22-28-29 (Tr. _____), which were followed up by MMA/USPS-14-19 (Tr. ___), which were followed up by MMA/USPS-26-27 (Tr. ____) and MMA/USPS-T22-53 (Tr. 4/603-4; 9/2365-66).

[13] The Postal Service cannot explain why BMM costs decreased by .2% when all single piece costs increased by 2%. *See* Tr. ___. (Response to MMA/USPS-27(B) – (D).

E. First-Class Shape-Based Rates

In a long overdue move to reduce intra-class subsidies, the Postal Service has proposed new categories of First Class to allow rates to better track cost causation. To attain this goal, the Postal Service takes full advantage of shape as a cost driver in both First-Class single piece and bulk.

1. First-Class Single Piece

The Postal Service proposes to charge all First-Class single piece 1-ounce mail based on the shape of the mail piece. This proposal seems eminently fair and is long overdue. Current rates charge the same basic rate regardless of shape, except for a nonmachinable surcharge assessed on the first ounce. The new rate structure will eliminate the nonmachinable surcharge in favor of separate rates depending upon whether the mail piece can be processed as a letter, flat or a parcel. Since each of these shapes have different processing and delivery costs, the new rate structure tends to allow rates to better track costs to an extent never before possible.

Shape-based rates also send appropriate economic signals to mailers to drive costs out of the postal system. Consider the specific case of a 1.6-ounce flat that consists of, say, 7 pages that could easily be folded to fit into a letter envelope. Currently, that flat pays the same rate as a letter of the same weight but the costs of processing and delivering the flat are significantly higher than the costs for a letter. The proposed rates will provide a direct, monetary incentive for mailers to replace flats with letters, whenever possible. The superior price signal sent by the Postal Service's proposal will benefit all mailers and the postal system.

2. First-Class Presort

The Postal Service proposes to implement shape-based rates for bulk First-Class as well. The rates are already shape based for letters and flats, but now it proposes to establish a category for bulk parcels. As for First-Class single piece, this proposal makes sense and I urge the Commission to adopt a separate category for bulk parcels However, after reviewing USPS witness Taufique's intended benefits for instituting rates that better track costs, I am concerned that

he has missed an important opportunity to foster this goal by his failure to consider that volume is a significant cost driver within the First-Class workshared category.

There can be no doubt that the postal costs to service one mailer who consistently sends out one million letters per day are considerably lower than to service 1,000 mailers that send 1,000 letters per day. The efficiencies associated with preparing and handling large volumes versus small volumes of letters are obvious since volume alone makes it possible for larger mailers to perform worksharing operations that Postal Service employees must ordinarily perform for smaller mailings. These functions include:

<u>Mail Acceptance</u>

- Postage verification, including on-site MERLIN systems;
- Consolidation of mailing statements;[14]
- Electronic transmission of weight and volume data to Postal data centers, including the use of PostalOne!; and
- Electronic transmissions of all postal paperwork, including the use of PostalOne!.

<u>Traying letters</u>

- Preparing and applying Destination and Routing (D&R) labels, including the use of PostalOne!;
- Weighing the trays; and
- Presorting the trays of mail prior to placing them onto pallets or other containers.

<u>Palletizing the trays</u>

- Stacking trays onto pallets;
- Shrinkwrapping full pallets to secure trays during transport by the USPS;
- Labeling pallets; and
- Separating and presorting pallets prior to the point at which they are loaded onto trucks.

[14] I understand that MMA members routinely consolidate ***hundreds*** of individual mailing statements into one consolidated mailing statement for the benefit of the Postal Service.

Loading mail onto trucks

Moving full labeled pallets to the workshare mailer's loading dock;
Loading pallets onto USPS trucks;
Meeting USPS scheduling requirements; and
Presorting trucks with presorted pallets.

Consistent high volume mailings also serve to minimize postal transportation and related costs as well. Trucks can be filled at the mailer's location and sent directly to an airport or HASP and often directly to a destinating postal facility. Such mail bypasses intermediate processing locations and avoids operations such as cross docking and breakdown, re-sortation of trays onto pallets and shrinkwrapping the new pallets.

The current First-Class workshared rate structure does not directly take into account the cost sparing attributes that volume affords the Postal Service. As such, the one large mailer and the 1,000 small mailers described above could pay the exact same postage per piece. Yet the costs of delivering the letters are far different, resulting in a revenue generating pattern that for too long does not track costs. Given the vast technological changes that have taken place over the past decade, as well as the consolidation within the workshared industry, I urge the Commission to direct the Postal Service to consider volume as a specific cost driver to be reflected in the rates offered. Such a result could justify a small discount to mailers who send out large mailings combined with a small increase to mailers who send out small mailings. Since such a price signal reflects actual cost causation, the resulting rate structure would reduce the cross subsidization that is now apparent and provide much more equitable and efficient rates.

F. First-Class Additional Ounce Rates

The Postal Service's proposal for reduced additional ounce rates, particularly for letters, is long overdue. The degressive rate structure has long recognized that the second and third ounce requires much less effort to process than the first ounce, and the Postal Service's proposed rates reflect this reality

more than ever before. If anything, the Postal Service has not gone far enough in reducing the additional ounce rates for letters. Nevertheless, I urge the Commission to accept the Postal Service's proposal. The newly proposed additional ounce rates move in a direction that is entirely consistent with the Commission's actions and should be approved.

There are other reasons that support the Postal Service's 15.5 cent additional ounce rate for Presorted letters. Because the 15.5 cent additional ounce rate brings First Class Presort rates more in line with costs, it provides some disincentive for First-Class mailers to continue the practice of routinely splitting up their First-Class content from their advertising content, in order to take advantage of the much lower Standard automation rates for 2 and 3 ounce letters. The current additional ounce rate sends entirely the wrong price signal since breaking up one First Class mailing into a First Class mailing and a separate Standard mailing results in lower postage for the mailer but ***much*** higher costs for the Postal Service.[15]

MMA has informed me that a large mailer was recently faced with such a conundrum. The content to be mailed weighed less than 3 ounces. Some of the content had to be mailed at First-Class rates but the remaining portion could be mailed as either First Class or Standard mail. The volume totaled 1.8 million pieces. By spending an additional $40,000 in labor and supply charges, the mailer was able to split each letter up into a First-Class letter weighing under one ounce and a second Standard letter that paid the minimum rate. The result was that the Postal Service processed and delivered twice the volume – 3.6 million pieces – and received $400,000 less postage. This obviously inefficient practice needs to be discouraged. The proposed reduction for the additional ounce rate will make the practice of splitting up mailings much less attractive.

[15] In R2000-1, MMA witness Mury Salls explained this routine practice whereby mailers take full advantage of the flat rate offered for Standard Automation letters when contemplating a 2 – 3 ounce First-Class mailing with advertising content. *See* R2000-1, Exhibit MMA-T-3.

The lower additional ounce rate for First-Class presorted letters also impacts the industry-wide means for monitoring postage called "selective inserting." This practice insures that the weight of a letter does not exceed the one ounce price point. If an advertising insert triggers additional postage, mailers will make a specific determination to either (1) pay the additional postage, (2) postpone insertion of the advertising piece, or (3) forego advertising by mail in favor of alternative methods of reaching their customers. The second and third choices are potentially harmful to the Postal Service. Advertising generates additional First Class mail volume which could be temporarily or permanently lost.

Finally, the lower additional ounce rate for presorted letters is consistent with the USPS witness O'Hara's revenue requirement established for such pieces. Given the exceedingly high implicit cost coverage for First Class workshared mail, which is still more than 300%, the lower additional ounce rate is consistent with reaching an overall First-Class cost coverage that is fair and equitable.

G. QBRM Letters

QBRM letters represent a very special type of First-Class single piece letter within the Postal Service. On the one hand, QBRM exhibits the same cost sparing attributes of Automation letters. These include a prebarcode, pre-approved addressing and outside envelope requirements compatible with automation, and a reliable and accurate address. In addition, QBRM letters are often delivered to a post office box in very large quantities. This attribute not only reduces incoming secondary sort costs but often eliminates delivery costs as well.[16] On the other hand, QBRM incurs extra costs associated with mail preparation operations, since they are deposited along with other First-Class single piece collection letters.

[16] Though very significant, delivery cost savings are not included in the measure of QBRM savings.

To reflect these special attributes, QBRM currently receives a 3.2-cent discount from the basic First-Class rate. The Postal Service proposes to reduce this discount to 2.5-cents. High Volume QBRM recipients also pay a per piece fee, which the Postal Service proposes to increase by 12.5%, from 0.8 cents to 0.9 cents. I urge the Commission to reject both Postal Service proposals. I recommend that the QBRM discount be increased to *at least* 4.0 cents. The High Volume QBRM per piece fee should be eliminated entirely or be reduced to no more than 0.5 cents.

1. QBRM Cost Savings

The cost analysis supporting the QBRM discount was last approved by the Commission in R2000-1. The Commission's analysis compares the costs to process a specially prepared QBRM letter with the costs to process a similar letter that is hand-addressed (HAND letter). Cost savings are based on all processing operations from acceptance through the incoming secondary sortation operation, and primarily reflect the RBCS cost of barcoding HAND letters and the higher percentage of HAND letters (compared to QBRM letters) that must be processed manually throughout the mailstream.

Both QBRM and HAND letters enter the general mailstream with all other collection mail. QBRM is then separated from other mail using the special FIM marking that is recognized by automated equipment within the mail preparation operations or the RBCS. From that point on, QBRM is processed by automation. HAND letters remain combined with all other single piece letters and are processed through the RBCS where, to the extent possible, they are "read" by machines or off-site postal employees and have a barcode applied. From that point on, HAND letters are processed by automation (to the extent possible). The currently approved methodology estimates the unit costs for QBRM and HAND and computes the difference to derive the savings due to the special cost sparing features of prebarcoded, automation compatible QBRM.

The Postal Service's methodology for deriving QBRM cost savings is flawed for two reasons. First, the Postal Service method models QBRM and HAND letters only as far as the first outgoing sortation, thus ignoring entirely the

additional savings that accrue after that point in processing. Second, when the Postal Service reconciles its model derived results with the CRA, it applies the wrong CRA Proportional Adjustment factor to the QBRM model-derived unit cost, thereby understating the derived cost savings.

Correcting for both of these Postal Service errors results in a QBRM unit cost savings of 6.75 cents, a full 5.26 cents more than the savings derived by the Postal Service (1.49 cents). Accordingly, far from supporting a reduction in the QBRM discount, the evidence supports an ***increase*** in the discount to ***at least*** 4.0 cents.

Technical Appendix II to my testimony provides a technical discussion of the shortcomings associated with the Postal Service's QBRM cost savings analysis, explains why that methodology severely understates actual cost savings, and demonstrates that actual QBRM unit cost savings exceed 6 cents.

2. QBRM Per Piece Fee

The Postal Service's proposal to increase the High Volume per piece fee by 12.5% is based upon a new, but flawed BRM Practices Study recently conducted by the Postal Service. *See* Library Reference USPS-LR-L-34. Among other things, that "study" estimates that 27% of all High Volume QBRM, more than 40 million pieces per year, is hand counted. With counting machines and weighing techniques that are more than 12 times as productive and readily available to all post offices, there is no excuse for hand counting High Volume QBRM letters. Certainly, the Postal Service must not be rewarded for such inefficiency.

Several considerations lead me to suspect that the Postal Service's estimate that 27% of high volume QBRM is hand counted is simply wrong. This is not the first time that the Postal Service has tried, and failed, to convince the Commission that it laboriously hand counts QBRM received in very large quantities day-in and day-out. Apparently the Postal Service has not learned from its past mistakes and history has repeated itself in the latest BRM Practices Study.

In R2000-1, USPS witness Campbell relied on a 1997 BRM Practices Study that was basis for the study relied upon by the Postal Service in this case. Back then, the BRM Practices Study led Mr. Campbell to conclude that 46% of QBRM volumes received in high quantities were counted manually. After this practice was seriously questioned, Mr. Campbell went back to the drawing board and, using the CBCIS and other data systems, obtained specific counting information for the top 77 High Volume QBRM recipients by means of a survey. Using this new information, I presented my own study that concluded only 11% of these pieces were hand counted. In that case, the CBCIS data proved that the BRM Practices Study results were not representative of High Volume QBRM recipients and the Commission agreed. It accepted my analysis of the CBCIS data and stated on page 552 of its Opinion,

> The updated processing information supplied by Campbell shows results that implausibly seem to favor manual counting, the most inefficient counting method. (Tr. 14/6030) It is easy to believe that high volume offices would use the more efficient counting methods; it strains credulity to think that offices receiving large volumes would hand count most or all of the pieces…

In R2001-1, just a year later, USPS witness Miller conducted a more detailed survey of the top 151 High Volume QBRM recipients. He found that almost none (just 0.4%) of High Volume QBRM volumes were counted manually. I seriously question the reasonableness of the new sampling study that estimates 27% of today's High Volume QBRM is actually counted manually.

The Postal Service derives a unit cost of 0.458 cents for counting QBRM. Almost 90% of that cost figure is tied ***directly*** to the obviously erroneous assumption that 27% of all High Volume QBRM letters are counted manually. Had the Postal Service assumed the same productivity for counting such pieces by either weighing or counting machines, the unit cost would have been 0.087 cents, a reduction of 81%.[17] As shown in Technical Appendix II, my analysis of

[17] The unit cost reduction is similarly 81% using the Commission's attributable cost methodology rather than the Postal Service's methodology. *See* Library Reference USPS-LR-L-104.

QBRM counting costs indicates that the per piece unit costs for High Volume QBRM are very low, well under 0.10 cents.

For these reasons, I urge the Commission to reject the Postal Service's derived unit costs for counting High Volume QBRM. Instead of raising the per piece fee as the Postal Service proposes, the Commission should eliminate the per piece fee because the attributable costs are virtually zero. If the Commission is not prepared to eliminate the per piece fee, it should set the fee at 0.5 cents or lower. With an attributable cost that ranges from 0.012 to 0.070 cents, the implicit cost coverage of a 0.5 cent fee ranges from 714% to 4,166%.

H. Confirm Service

Confirm Service is a relatively new "high tech" service provided by the Postal Service introduced as a result of MC2002-1. Confirm allows mailers the ability to track both their outgoing and incoming mail through scans that are recorded and reported as the letters are sorted on barcode sorters and other postal equipment. Subscribers routinely use information provided by Confirm to identify service problems and to provide better service to their customers.

The current Confirm rate structure offers three levels of subscription services, Silver, Gold and Platinum, depending on how many "scans" a customer expects to utilize. Platinum service, the most expensive level, entitles a mailer to receive information from an unlimited number of scans for a fixed price of $10,000 per year. The Postal Service proposes to eliminate this top tier by introducing a new rate structure that charges on the basis of scans received, which subscribers purchase in blocks of 1 million scans.[18] Table 9 shows illustrative percentage fee increases faced by current Platinum level subscribers under the Postal Service's proposal for various blocks of 1 million scans.

[18] For subscribers who use Confirm with First Class mail pieces, a "unit" is equal to one scan.

Table 9
USPS Proposed Fee Increase For Confirm Service

Number of First-Class Scans (Millions)	Proposed Increase
100	-12%
250	14%
500	58%
1,000	145%

Source: Tr. 14/3918-19

The Postal Service's proposed rates are also expected to generate a 49% increase in revenues compared to the current rates. Such an increase seems exceedingly high compared to the average proposed increase of just 8.5%, but USPS witness Mitchell characterizes the revenue requirement goal, that produces a cost coverage of 126%, as "modest". As Mr. Mitchell explains, a "modest" cost coverage is desirable because "demand for the product has not met the forecast used in MC2002-3". (See USPS-T-40, p. 19)

The Postal Service's Confirm Service proposal in this case is problematic for several reasons. First and foremost, the proposed 49% increase in revenues seems exceedingly high for a new service that still is in its infancy. If the Postal Service is serious about increasing usage for this service, the magnitude of this increase is counterproductive. I am informed that existing Platinum subscribers, who face double and triple digit increases are considering curtailing or eliminating their use of Confirm.[19] Other mailers who are considering this service have suspended such plans, pending the outcome of this case.

[19] One option under consideration is to use a sampling of scans rather than all scans as a means for reducing Confirm costs, if the proposed restructuring of the Confirm fee structure is implemented.

Second, the proposed fee schedule charges customers based on the number of scans required, which is counter to the manner in which costs are incurred. The evidence provided by the Postal Service indicates that the costs generated by providing Confirm ***do not change*** with the number of scans produced. In fact, according to USPS witness Page, 61% of the costs are totally fixed while the remaining costs, though categorized as variable, likewise bear no relationship to the number of scans produced.[20] Accordingly, the Postal Service's proposed rate structure is not cost based and sends the wrong pricing signals to the market.

Third, it appears that the proposed new pricing structure may not produce the revenues that the Postal Service has projected. Since the available data is inconsistent with the proposed fee structure, the Postal Service has engaged an exceptional amount of judgment in estimating the billing determinants and resulting revenues. Tr. 14/3926-7. Consequently, there is no way for the Commission to replicate or confirm the revenue projections.

Finally, it appears that the Postal Service may be missing a real opportunity here to cement its position as the premier service provider for businesses to reach their customers. As USPS witness Mitchum explains, Confirm Service is "an integral part of the Postal Service's overall effort to increase greater value to mailers." (USPS-T-40, p. 14) Mr. Mitchum is absolutely correct. Confirm Service can be a very useful tool, especially for larger mailers. As such, it can provide workshared mailers with a significant incentive for maintaining volumes within the postal system. But Confirm Service also provides a very important management tool for the Postal Service that pinpoints service problems and measures its ability to meet operational standards and service goals. There can be no doubt that Confirm Service is a win-win situation for both parties. The Postal Service must be very careful in its

[20] USPS witness Page could not adequately explain why 41% of the costs are "variable" when they obviously do not relate to the number of scans. Such costs concern "help desk" costs, which more likely vary with the number of subscribers, and "travel" costs associated with promotional activities. Moreover, USPS witness Page could not explain why he categorized such costs as variable, other than to state that he was told to do so. *See* Tr. ___. (Responses to MMA/USPS-T23-1 and 3)

pricing structure to assure that more, not fewer, mailers will take full advantage of the system that is now in place.[21]

My primary proposal is that, at least for First Class workshared mailers, the Commission should recommend outright elimination of the additional fees for blocks of 1 million scans. First Class Confirm subscribers would pay a fixed annual fee, for example of $2,000,[22] to cover the costs of setting up and maintaining their accounts. Payment of this annual fee would entitle a Confirm subscriber to receive an unlimited number of scans.

Several reasons support adoption of my primary proposal. First, adding Confirm as an extra feature of First Class wokshared mail would enhance the value of workshared mail, especially for very high volume mailers who are most likely to divert significant volumes of mail to electronic delivery and payment options. In addition to providing large mailers with a strong incentive to keep using the mails, my proposal is likely to attract additional subscribers by making Confirm more affordable for hundreds or even thousands of medium sized mailers. In contrast, the Postal Service's marketing approach of raising Confirm revenues by 49% will certainly discourage the entry of new subscribers, and, more than likely, cause current subscribers re-evaluate their decision to use Confirm service. Finally, the Postal Service's offering of Confirm as a separate service is out of step with the way competing delivery companies treat similar tracking services – as an integral, rolled-in feature of the delivery services they provide.

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[21] The Postal Service's proposal to increase Confirm fees also does not take into consideration the significant costs incurred by subscribers to organize and analyze the raw data provided by Confirm. Such costs play an important role in a potential subscriber's decision to sign up for the service.

[22] An annual fee of $2,000 would generate several hundred thousand dollars from existing Confirm subscribers and perhaps even more from potential new subscribers. The annual fee revenues would help to offset the estimated $1.2 million cost of providing Confirm Service. In any event, the necessary costs associated with providing Confirm Service are quite small in comparison to the huge institutional cost contribution that First Class workshared mailers make to the postal system.

As an alternative to eliminating the fee for Confirm scans, I recommend that the structure, including the "Platinum" subscriber level with unlimited scans be retained. The impact on current Confirm subscribers is far too great and the potential rate shock has not been adequately considered by the Postal Service. Moreover, the overall increase of 49% should be reduced. For a service that benefits both mailers and the Postal Service, the rate increase should be absolutely minimized.

Finally, I note that the Postal Service is proposing to eliminate existing DMCS language that allows the mailer and the Service to know when the clock starts to run on mailings. I urge the Commission to reject the Postal Service's proposal to eliminate this "start-the-clock" provision. Subscribers can and do use Confirm data to identify areas in which the Postal Service is failing to meet its own delivery standards, to bring such problems to the attention of postal operations specialists, and to work cooperatively with the Postal Service to solve the bottlenecks and other causes of such problems. With the existing start-the-clock provision there is no question when a particular problem mailing was entered. Without such a provision, the usefulness of Confirm data could be compromised.

V. SUMMARY AND CONCLUSIONS

Based on the analyses in my testimony and technical appendices, my conclusions are as follows:

1. The Commission should recommend the Postal Service's proposed discounts for First Class workshared mail.

2. MMA supports the Postal Service's de-linking proposal and applauds the Service for seeking a simpler, less controversial method for setting workshared mail rates.

3. The Commission should adopt my adjustments to the USPS methods for supporting the First Class workshared discounts under de-linking. As shown in Table 2, a portion of which is reproduced below, the cost savings I have derived justify the discounts. All of the percentage passthroughs are well below 100%.

First Class Workshared Category	USPS Proposed Discount	USPS Proposed Incremental Discount	TY 2008 Total Workshared Unit Cost*	Incremental Unit Cost Savings	Incremental % Passthrough
MMA					
Auto Mixed AADC	7.4		12.17		
Auto AADC	8.5	1.1	10.22	1.95	57%
Auto 3-Digit Letters	8.9	0.4	9.53	0.70	58%
Auto 5-Digit Letters	10.8	1.9	7.30	2.22	85%

4. Application of a more traditional cost savings approach to setting discounts also supports the specific discounts proposed in this case. Should the Commission decide to retain its traditional cost savings approach, it should rely on the costs savings analysis presented in my testimony. As shown in Table 3, which is reproduced below, the cost savings I have derived justify the discounts. As with my de-linking analysis, all of the percentage passthroughs are well below 100%.

First Class Workshared Category	**USPS Proposed Discount**	**MMA Derived Unit Cost Savings**	**Total % Passthrough**	**USPS Proposed Incremental Discount**	**MMA Derived Incremental Unit Cost Savings**	**Incremental % Passthrough**
NonAutomation	2.0	2.9	70%	2.0	2.9	70%
Auto Mixed AADC	7.4	8.5	87%	5.4	5.6	96%
Auto AADC	8.5	10.5	81%	1.1	1.9	57%
Auto 3-Digit Letters	8.9	11.1	80%	0.4	0.7	58%
Auto 5-Digit Letters	10.8	13.4	81%	1.9	2.2	85%
Auto CR Letters	10.8	13.4	81%	1.9	2.2	85%

Source: MMA-LR-1, page 1

5. IOCS redesign has resulted in significant, disproportionate cost shifts to First Class workshared mail. The Postal Service has not provided an adequate explanation for these costs shifts. Accordingly, the Commission should require the Postal Service to demonstrate that these cost shifts are not the result of inherent bias in the new system for collecting and assigning tallies.

6. The Postal Service's shape-based rate proposals within First Class allow rates to better track costs and send proper price signals to mailers.

7. The Postal Service has not adequately recognized volume as a primary cost driver in its construction of rates proposed in this case. The current one-discount-fits-all approach to First Class workshared mail discounts discriminates against many high volume mailers who perform additional worksharing that smaller mailers cannot and do not perform. Workshared rates have not kept up with technological advancements associated with worksharing. The Commission should direct the Postal Service to study the effects of consistently high volume mailings on cost savings and consider appropriate de-averaged workshared discounts in the next omnibus rate proceeding.

8. The Postal Service's proposal to lower the additional ounce rate for First-Class single piece and workshared letters is long overdue and provides rates that are more shaped based than ever before.

9. The Commission should reject the Postal Service's proposals to reduce the QBRM discount to 2.5 cents and to increase the High Volume per piece fee to 0.9 cents. A proper analysis of the associated costs shows that the QBRM discount should be increased to *at least* 4 cents and the per piece fee should be eliminated entirely or reduced to 0.5 cents.

10. The Postal Service's proposal to completely revamp the rate structure for Confirm Service is ill-conceived, unreasonable and should be rejected. In view of the minimal costs associated with Confirm, this service should be provided as a service enhancement to First Class workshared mailers, subject only to payment of a reasonable annual fee. Subscribers should be entitled to unlimited scans. In the alternative, the existing three tier rate structure should be retained, especially the unlimited scan feature of Platinum level service, and the proposed 49% revenue increase should be reduced considerably.

Attachment 1
Qualifications of Richard Bentley

Richard Bentley is self-employed as a postal rate consultant.

Mr. Bentley began his career as a market research analyst for the Postal Rate Commission in 1973 and remained until 1979. As a member of the Officer of the Commission's (OOC) technical staff (now Office of the Consumer Advocate) his responsibilities included analysis of USPS costs, volumes, rates and operations. As a witness on behalf of the Officer of the Commission (OOC), Mr. Bentley testified before the Postal Rate Commission in five separate proceedings.

In MC73-1, Mr. Bentley filed rebuttal testimony concerning the Postal Service's bound printed matter proposal. During this time Mr. Bentley also worked on an OOC proposal for shape-based First-Class single piece rates, similar to those proposed by the Postal Service in the instant proceeding.

In Docket Nos. MC76-1 and MC76-3, Mr. Bentley testified on changes proposed by the Officer of the Commission to the Domestic Mail Classification Schedule. Those changes concerned proposals to establish local First-Class rates and to eliminate third-class single piece as a separate subclass. With regard to the latter, it is interesting to note that 20 years later, the Commission eliminated this subclass as one of its recommendations in R97-1.

In R77-1, Mr. Bentley presented proposed rates for all classes of mail and services, including the projected volumes that would result from those rates. He also analyzed the rates proposed by the Postal Service and critiqued the volume projections presented in support of its proposals.

In MC78-1, the Postal Service proposed to restructure parcel post rates by asking the Commission to establish new rates for parcel post mailed in bulk and for a parcel post nonmachinable surcharge. Mr. Bentley presented two pieces of testimony in that docket -- one concerned with the rate aspects of the Postal Service's proposal and one concerned with the parcel post volume projections.

In 1979, Mr. Bentley left the Postal Rate Commission to become a senior program engineer for Systems Consultants, Inc. (which later became Syscon Corporation), a national consulting firm. There, Mr. Bentley's responsibilities included the analysis and estimation of life cycle costs required to research, develop, manufacture, and maintain various weapon system programs for the Department of Defense. He developed cost estimating relationships and completed a computerized model for estimating future weapon system program costs.

In addition, Mr. Bentley testified before the Postal rate Commission in R80-1 concerning presorted First-Class mail rates and second-class within county rates.

After leaving Syscon in 1981, Mr. Bentley started his own company, Marketing Designs, Inc., which provided specialized marketing services to various retail, commercial, and industrial concerns as well as consulting services to a select group of clients. Marketing Designs, Inc. closed in 2005.

In R84-1, Mr. Bentley testified on behalf of the Council of Public Utility Mailers and the American Retail Federation in favor of an increased First-Class presort discount. At that time Mr. Bentley presented a methodology for estimating cost differences between processing First-Class single piece and presorted letters that eventually become the foundation for the Commission's "Appendix F" methodology for supporting First-Class presorted discounts.

In C86-3, Mr. Bentley testified on behalf of Roadway Package System concerning a proposed special rate increase for parcel post.

In R87-1 and R90-1, Mr. Bentley testified on behalf of the Council of Public Utility Mailers, the National Retail Federation, Brooklyn Union Gas, and other First-Class mailers. Mr. Bentley recommended and supported various rate discount proposals for presorted First-Class mail, and a lower fee for "BRMAS" business reply mail.

In R94-1, Mr. Bentley testified on behalf of Major Mailers Association with respect to several issues that concerned First-Class rates. These included the relationship between the proposed cost coverages for First and third class, the

rates for First-Class incremental ounces, prior year losses, and the Postal Service's changes to the Commission's city delivery carrier out-of-office cost methodology. In addition, Mr. Bentley worked on behalf of Brooklyn Union Gas to have the Postal Service's proposed tripling of the "BRMAS" BRM fee rejected, although he did not file any formal testimony.

In Docket Nos. MC95-1 and MC96-3, Mr. Bentley again represented Major Mailers Association. In MC95-1 he endorsed the overall classification concept proposed by the Postal Service for First-Class Mail and suggested that the First-Class second and third ounce rate be reduced for letter-shaped pieces. In MC96-3, Mr. Bentley compared the attributable costing approaches between the Postal Service and Commission and asked that the Commission require the Postal Service to provide the impact of proposed changes utilizing established attributable cost methodologies. This testimony was the impetus for RM97-1 and resulted in the Commission amending Rule 54(a)(1) to require the Postal Service to make such a cost presentation.

In R97-1, Mr. Bentley represented both Major Mailers Association and the Brooklyn Union Gas Company with two separate pieces of testimony. For Major Mailers, he recommended that the Commission reject the Postal Service's newly proposed cost attribution methodology, increase First-Class discounts and offer a reduced rate for 2-ounce First-Class letters. For Brooklyn Union, he endorsed the Postal Service's Prepaid Reply Mail concept, but asked the Commission to alter it slightly with two modifications.

In R2000-1, Mr. Bentley again appeared as a witness for Major Mailers Association and KeySpan Energy, previously known as Brooklyn Union Gas. In that docket, Mr. Bentley showed the workshare cost savings were greater than those derived by the Postal Service, and he recommended workshare discounts that reflected those cost savings. He also provided the Commission with the means for recommending a two-tiered QBRM fee based on the volume received. This proposal was originally suggested by the Postal Service, but its supporting analyses were so flawed that ultimately the Commission was forced to reject them in favor of Mr. Bentley's supporting evidence.

In R2001-1, Mr. Bentley appeared as a surrebuttal witness on behalf of Major Mailers Association and KeySpan energy. Mr. Bentley filed testimony in support of the proposed settlement in that case, particularly with respect to First-Class workshared and QBRM rates and fees, and in opposition to rebuttal testimony filed by the American Postal Workers Union.

In the last omnibus rate proceeding, R2005-1, Mr. Bentley again represented the interests of the Major Mailers Association. Mr. Bentley filed no testimony because that case was eventually settled by the parties.

In 1972, Mr. Bentley received a Bachelor of Science degree in Industrial Engineering/Operations Research from Cornell University. The following year Mr. Bentley was awarded a Master's degree in Business Administration from Cornell's graduate School of Business and Public Administration (now the Johnson Graduate School of Management). Mr. Bentley is a member of Tau Beta Pi and Alpha Pi Mu Engineering Honor Societies.

Exhibit MMA-1A
Estimated Impact of IOCS Redesign on First-Class Single Piece and Presorted Letters
(PRC Cost Methodology)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
							With IOCS Redesign		
Letter Rate Category	BY 2004 Unit Cost (Cents)	BY 2004 Volume (000)	BY 2004 Cost ($000)	BY 2004 Unit Cost (Cents)	BY 2005 Unit Cost (Cents)	BY 2005 Volume (000)	BY 2005 Cost ($000)	BY 2005 Unit Cost (Cents)	Unit Cost Ratio BY 2005/BY 2004
Single Piece	13.3520	40,932,061	5,465,243	13.3520	13.6137	39,317,031	5,352,497	13.6137	
Presorted	4.4973	46,509,242	2,091,646	4.4973	4.7743	48,147,533	2,298,695	4.7743	
Total		87,441,302	7,556,889	8.6422		87,464,564	7,651,193	8.7478	1.01221

	(10)	(11)	(12)	(13)	(14)	(15)
	Without IOCS Redesign and with Equal Increases for S.P. and Presorted					
Letter Rate Category	BY 2005 Unit Cost (Cents)	BY 2005 Total Cost ($000)	BY Unit Cost (Cents)	BY 2005 Unit Cost Shift (Cents)	BY 2005 Total Cost Shift ($000)	% Change in BY 2005 Total Cost
Single Piece	13.5150	5,313,701	13.5150	0.0987	38,796	0.7%
Presorted	4.5522	2,191,763	4.5522	0.2221	106,932	4.9%
Total		7,505,464	8.5811	0.1666	145,728	1.9%

(1) USPS-LR-K-99, shp04PRC
(2) USPS-LR-K-99, shp04PRC
(3) (1) x (2) x .01
(4) (3) / (4) x 100
(5) USPS-LR-I-99, shp05PRC
(6) USPS-LR-I-99, shp05PRC
(7) (5) x (6) x .01
(8) (7) / (6) x 100
(9) (8) / (4)
(10) (4) x (9)
(11) (6) x (11) x .01
(12) (12) / (6) x 100
(13) (8) - (13)
(14) (7) - (12)
(15) (15) / (12)

Appendix I
Technical Discussion: Derivation of Workshared Cost Savings

The source for derived workshared cost savings involves both mail processing and delivery operations. Savings from each operation are derived separately and then combined to derive total workshared-related unit costs. The difference between each individual workshared category's unit cost and the benchmark provides a traditional estimate of the unit cost savings. A detailed description of the derivation of mail processing and delivery unit costs follows.

I. Derivation Of Mail Processing Cost Savings

In order to derive unit cost savings by presort level for First-Class workshared letters, the methodology employed in MMA-LR-1 utilizes various portions of the methodologies previously provided by the Commission and Postal Service. Where appropriate, I have selected elements of the methodology that are consistent with positions that I have taken in the past.

My analysis focuses on the following six areas involved in the derivation of mail processing workshared-related unit costs:

A. Attributable Cost Methodology
B. Benchmark Mail Piece
C. Cost Pool Classifications
D. De-averaging Nonautomation and Automation Costs
E. CRA Proportional Adjustment Factors
F. Delivery Point Sequencing Percentages

A. Attributable Cost Methodology

Since R97-1, the Postal Service has endorsed its own version of attributable costs that assumes costs vary with changes in volume at less than 100%. The Commission has repeatedly rejected this premise and has preferred instead to base its recommended rates on an attributable cost methodology that generally assumes 100% cost variability. I have elected to use the Commission's costs in the expectation that the Commission will again reject the Postal Service's proposed costs.

B. Benchmark

Selecting an appropriate benchmark from which to measure workshared cost savings has been extremely controversial to say the least. During the 1980's and early 1990's, the Commission utilized average single piece letters as the basis for determining presort cost savings. Later in the 1990's, as worksharing became more sophisticated, particularly with widespread implementation of mailer applied barcodes and the Postal Service's investment in automation technologies, the Commission adopted bulk metered mail (BMM) letters as the worksharing benchmark.

BMM letters are assumed to be nonprebarcoded, "clean" letters with typewritten addresses that are faced and brought to the local post office in properly prepared trays. The Commission's related assumption is that BMM is the type of single piece mail most likely to convert to workshared mail and the type of single piece mail to which potentially some workshared mail might revert.

In R2000-1, more than six years ago, I argued that single piece metered mail letter (MML) costs should be the appropriate nonworkshared letter category from which savings should be measured. (R2001-1, MMA-T-1, pages 19-22) I reviewed the maturation of First-Class bulk letters and concluded that the Commission's initial hypothesis that BMM was the most likely single piece mail to migrate to bulk could not be substantiated. In the ensuing years, First-Class bulk has developed its own, unique identity which bears little relationship to single piece,[1] and the notion that substantial volumes of single piece mail can be converted to bulk workshared mail is even less realistic. Given the significant technological changes that have affected worksharing and mail preparation, the availability of electronic alternatives to First-Class mail, as well as the

[1] Much of the "growth" in First Class workshared mail volumes has nothing to do with conversion of single piece mail to workshared. Instead, such growth results from increased business activities of existing workshare mailers.

restructuring and considerable consolidation among workshared mailers over the past few years,[2] using BMM as the benchmark is no longer appropriate.

There are six major cost attributes that constitute worksharing: volume, mail preparation, prebarcodes, presortation, mail-piece design and address hygiene. All of these attributes, which reflect required tasks for workshared mailers, reduce postal costs. Therefore it seems reasonable that in order to measure the cost impact of worksharing, the benchmark mail piece should include these attributes of worksharing, but only to the extent they are present for an average single piece letter.[3] Further, in order for the benchmark mail piece to be usable, accurate and relevant cost information must be readily available.

BMM does not meet these criteria for several reasons. First and foremost, there is no basis to assume that BMM letters, if they in fact exist, are the most likely mail to shift from single piece to bulk. Nor is it likely that workshared mail would revert to BMM – or that single piece mailers would voluntarily deposit their letters in prepared trays at a local post office. The proliferation and success of presort bureaus proves that most of the single piece mail that ***theoretically*** could convert to workshared has already done so. USPS witness Taufique also agrees with this assessment. He testified that BMM is no longer the type of mail most likely to convert to workshared mail. In fact, he believes that, if one were to utilize a benchmark, average single piece letters would be more appropriate. Tr. 16/4932-3, 4937, 4939, 4946-7, 5039.

Second, workshared mailers, especially high volume mailers, have succeeded in converting their residual mail pieces to workshared status largely as a result of better address cleanliness software and procedures. MMA has informed me that, whereas these residual volumes constituted approximately 5%

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[2] In FY 2005, just 100 workshared letter permit numbers sent out more than 20 billion letters in PostalOne! equipped offices. That accounted for about 42% of the total presorted letter volume. See Tr. ___. (Response to MMA/USPS-5)

[3] It is apparent that a portion of "average" single piece currently incurs collection costs as part of the mail preparation cost attribute. Such costs are almost $1 billion in the test year. To the extent such pieces can shift to the workshared category, some collection cost savings should be included in the analysis of workshared cost savings. The same is true for window service costs. Nevertheless, to be conservative, I have assumed that there are no collection or window service cost savings.

of their total mail volumes 5 years ago, today's residual mail has been reduced to just 1-2%. High volume mailers also now routinely give their small residual volumes to presort houses. This is another reason to conclude that most single piece letters that potentially could convert to workshared have already switched. Third, the concept of using BMM as the benchmark severely discounts the significant mail preparation cost savings that have become an integral part of worksharing. Not only do workshared mailers prepare their letters in sleeved, strapped and pre-labeled trays, but the trays are often shrinkwrapped, pre-labeled and presorted on pallets as well. The assumption that BMM mailers routinely and voluntarily bring their mail to the local post office in trays, as workshared mailers are ***required*** to do, unfairly denies First-Class workshared mailers credit for these cost sparing operations. Given the technological changes that have made mail acceptance procedures so efficient, the Commission should re-instate the inclusion of mail preparation cost savings because of "fairness and equity", as it did in its R87-1 Opinion. (p. 472)

Finally, there are no direct CRA costs available for BMM. Accordingly, both the Postal Service and the Commission routinely use the actual CRA costs of MML as a proxy for BMM costs. In R2000-1 the Commission reduced MML preparation cost savings by two-thirds to reflect its assumption that BMM is entered in full trays while MML is not. In the next two omnibus rate cases, the Postal Service did not adopt the Commission's adjustment. Instead, the Postal Service used MML costs (without adjustment) as a proxy for BMM costs, but then argued that MML costs overstated BMM costs.[4] In this case, the Postal Service is unwilling to confirm that its own CRA-derived BMM unit cost estimates in those

[4] The Postal Service's argument failed to consider factors that tend to offset, to an unknown degree, the cost savings advantage that are assumed for BMM. By definition BMM is not prebarcoded. Since a significant portion of MML is prebarcoded, allowing letters to completely bypass the Remote Bar Code System, processing costs are lower for MML than for BMM. Moreover, unlike BMM, prebarcoded MML usually consists of pre-approved courtesy reply envelopes that rarely need to be forwarded or returned. According to USPS witness Taufique, as much as 15% of First-Class single piece letters are prebarcoded reply mail. Tr. 16/5038. On the other hand, BMM mailers often use address lists that tend to be unsupported and stale. All of these factors mitigate the mail preparation savings associated with BMM and could actually cause BMM to cost more than MML.

cases were accurate.[5] The Commission should not rely on a theoretical benchmark that affects almost 50 ***billion*** workshared letters if the Postal Service has such little confidence in its CRA-derived unit cost.

In reality, the CRA provides actual costs for only two categories of First-Class nonpresorted letters: all single piece letters and MML. First-Class single piece is truly heterogeneous, consisting of letters that cover the full spectrum of cost-causing attributes, including illegible hand-addressed "dirty" letters in need of manual processing and perhaps forwarding on one end of the spectrum, to prebarcoded, pre-approved courtesy reply envelopes that are completely machine processed on the other end. Generally, MML letters should be somewhat "cleaner" than all single piece letters and, as a result, exhibit somewhat lower processing costs.

As I predicted in R2000-1, more pervasive use of automation equipment, improved technology and more reliable scanning capabilities have reduced single piece letter processing costs relative to MML.[6] Table 1 below compares the unit processing cost of all single piece letters to those of MML from FY 1998 to FY 2004.[7]

Table 1
Comparison of Historic CRA Single Piece Letter Costs
(PRC Cost Method, Cents)

First-Class Single Piece Letter Category	FY 1998	FY 2000	FY 2004
All Single Piece	13.08	13.02	13.35
Metered Mail	11.23	11.43	12.64
Difference	1.85	1.60	0.71
% Difference	16.5%	14.0%	5.6%
Source: USPS-LR-	I-137	J-81	K-99

[5] When asked to confirm historical comparisons of the BMM model-derived and CRA-derived unit costs, USPS witness Abdirahman claims that the comparisons could not be confirmed because "the actual costs of BMM were not known" and "[t]he proxy…does not reflect 'actual' BMM letters cost." Tr. 4/551.

[6] *See* R2000-1, MMA-T-1, p. 21-22.

[7] BY 2005 data have been omitted because the Postal Service claims that, due to the IOCS redesign, such costs are not directly comparable to those in previous years.

As demonstrated in Table 1, the unit cost differences between processing average single piece and MML have been converging rapidly. In fact, the 1.85 cents difference experienced in FY 1998 shrank by almost 2/3, to just 0.71 cents in FY 2004. As the unit cost difference between these two categories continues to shrink in the future, it may not matter which category is used as the appropriate benchmark.

My preferred benchmark mail cost is the average cost for all First-Class single piece letters. Using the average cost for all First-Class single piece letters makes good sense because it allows for an accurate measurement of the true average cost savings between a single piece letter that is not workshared and a workshared letter.[8] Therefore, a strong case can be made for using all single piece letters as the appropriate benchmark, as USPS witness Taufique has suggested. Tr. 16/4939. However, I still hesitate to use this benchmark in this case because of the perception that some portion of single piece letters is "dirty" and the workshared discounts have never reflected cost savings due to "cleanliness" in the past. This is also the more conservative approach.

Under the circumstances of this case, therefore, the most appropriate benchmark is one made up of "clean" single piece letters generally sent by nonhouseholds that are normally not prebarcoded, not faced properly, and not placed in trays that the mailer brings to a local post office. I use the only available CRA costs – those for MML – as a proxy for my proposed benchmark.[9]

C. Cost Pool Classifications

Classifying cost pools is an important element of the workshared cost savings analysis. In MC95-1, all cost pools were classified as relevant and

[8] If workshared mailers include a CRM envelope in their outgoing mail pieces, the Postal Service requires them to be fully automation-compatible and prebarcoded with an 11-digit barcode on the envelope or insert. In other words, workshared mailers are required to make a portion of single piece mail extremely efficient to process but receive no credit for the resulting cost savings.

[9] In reality, this is the same benchmark used by the Postal Service in R2001-1 and R2005-1, and very close to the benchmark used by the Commission in R2000-1.

proportional to presort level. In R97-1, the Postal Service introduced the notion that some cost pools were proportional to presort level while others were "fixed" and, therefore, not related to presort level. Starting in R2000-1, the Postal Service began to eliminate certain cost pools altogether, a move that significantly reduced the derived absolute level of workshared cost savings.

There are sound reasons to include all cost pools in the cost savings derivation. As discussed in my R2000-1 direct testimony, the arguments I provided in opposition to removing any cost pools are still valid. *See* R2000-1, MMA-T-1, pages 16-17. First, the Postal Service's data collection systems lose accuracy the more costs are disaggregated to lower levels. Therefore, sampling errors become more prevalent the further costs are broken down into their individual components. In addition, the cost pools have been further massaged and disaggregated according to shape, have average piggyback factors applied, and are then projected into the test year. All these data manipulations tend to cast doubt on the accuracy of individual cost pool values.

A second reason for including all cost pools in the cost savings analysis is the undeniable fact that historically, unit costs for Automation letters and the MML benchmark exhibit a relationship that contradicts the Postal Service's hypothesis that certain cost pools have no impact on worksharing. If there was no relationship, then such costs should be close to one another and the computed differences should be fairly close to zero. I have reviewed data for what the Postal Service calls "nonworkshared-related, fixed" cost pools since R2000-1 BY 1998. For the five base years for which data is available, almost all of the computed differences for individual cost pools indicate that Automation costs are lower. In fact, when the differences for base years 1998, 1999, 2000, 2004, and 2005 are added together, they are all positive, meaning that automation letters consistently exhibit lower costs than MML.

An example illustrates this point.[10] Consider the cost pool REWRAP, which measures costs to repair mail that has become damaged during

[10] A similar analysis of other "nonworkshared-related, fixed" cost pools indicates that these are also positively impacted by worksharing. *See* MMA WP-1.

processing. The Postal Service has classified these costs as "fixed" with respect to presort level and assumed that they are unrelated to worksharing. This classification is unreasonable. The probability that a piece of mail will be damaged increases with the number of times it must be handled during processing. Therefore, it seems logical that workshared letters that do not receive individual processing until further "downstream" than single piece letters should incur lower REWRAP costs. This is in fact the case as shown in Table 2.

Table 2
Summary of Historical REWRAP Unit Costs for MML and Auto Letters
(PRC Cost Method, Cents)

Base Year	MML	Automation	MML - Automation
1998	0.007	0.003	0.005
1999	0.010	0.002	0.009
2000	0.013	0.002	0.011
2004	0.014	0.001	0.013
2005	0.013	0.003	0.010
Total	0.057	0.010	0.047

Sources: USPS-LR-I-137, I-482, J-84, K-99 and L-99

The only difference between the types of mail for which REWRAP unit costs are shown in Table 2 is that Automation letters are workshared while MML letters are not. If worksharing has no impact on REWRAP costs, then I would have expected that, over the 5 base years, some of the cost differences would be negative. Consistent positive differences between the costs for MML and Automation letters indicate that worksharing reduces REWRAP costs.

All told, the cost data indicate that automation letters cost less to process than MML in the cost pools that the Postal Service deems "nonworksharing related fixed." Therefore, there is no reason for eliminating these specific cost pools from the cost savings analysis, especially since removing them artificially reduces derived cost savings.

Notwithstanding the Postal Service's speculations that certain cost pools are unaffected by worksharing, the cost pools should not be eliminated from the cost savings analysis. If worksharing does not affect a particular cost pool, then

the unit costs for Automation and MML letters will be close and the difference will add nothing to the derived cost savings. If cost differences do exist, then workshared mail deserves full credit for its cost sparing attributes.

Again, the REWRAP cost pool is illustrative. The R2006-1 BY 2005 cost differential between MML and Automation letters is quite small, only .01 cents, as shown in Table 2 above. Therefore, leaving such costs in the analysis has ***no material impact*** on the derived cost savings. However, when all such differences are added up across all the cost pools that the Postal Service omitted in R2000-1, R2001-1 and R2005-1, the total reduction in derived workshared cost savings is significant.[11]

The Commission dealt with a similar issue in the past. In R84-1, the Commission's "Appendix F" methodology for measuring presort cost savings included savings in incoming secondary operations. In R87-1, the Commission concluded that incoming secondary costs were unaffected by presorting and effectively eliminated approximately one full cent of derived presort savings. In MC95-1, the Commission reversed itself and included incoming secondary savings in the cost savings analysis. Indeed, it went further by including ***all*** in-office and out-of-office delivery cost savings.[12]

Accordingly, I start with two cost pool classifications: (1) cost pools that are proportional to presort levels, and (2) cost pools that are fixed as to presort levels. However, given the constraints of the mail flow models to simulate only certain types of costs, I have further divided the cost pool classifications according to whether they are reflected by the models. I have classified all cost pools reflected by the models as proportional to presort levels in the same

[11] According to Postal Service data, the amount of workshared cost savings "lost" in R2000-1, R2001-1 and R2005 was 1.30 cents, .75 cents and .76 cents, respectively.

[12] The Commission specifically included all nonmodeled mail processing cost pools in its derivation of workshared cost savings indicating that the Postal Service's reasoning at the time was "intuitively sound." It went on to claim that it is "important" to understand such costs "as fully as possible." *See* MC95-1Opinion And Recommended Decision, page IV-128. In the ensuing ten years, the Postal Service has provided little new information regarding such costs. In fact, the most complete analysis has been provided by Pitney Bowes witness Buc who concludes that more than 70% of the nonmodeled costs are proportional to presort level. *See* PB-T-2 and Library Reference PB-LR-L-1.

manner suggested by the Postal Service. The remaining nonmodeled cost pools are then divided into two groups, proportional and fixed.[13] The three cost pool classifications become: (1) modeled and proportional, (2) nonmodeled but proportional, and (3) nonmodeled and fixed. There are no nonworkshared-related cost pools. I have also assumed that nonmodeled proportional costs are proportional to the modeled costs; and that the fixed costs are fixed as to presort level but in relation to proportional costs. *See* Library Reference MMA-LR-1, pages 3 and 7.

D. De-averaging Automation and Nonautomation Costs

In R2005-1, the accuracy of the CRA-derived unit costs for Automation and Nonautomation letters became a separate issue. As I understand the problem, the Postal Service's In-Office Cost System has trouble identifying Automation from Nonautomation letters, which permits Automation costs to be recorded as Nonautomation costs. The result is an alleged overstatement of Nonautomation costs. To solve this problem the Postal Service has decided to combine Automation and Nonautomation costs and used its mail flow models to de-average the combined Presorted unit cost into Automation and Nonautomation.

I have followed the procedure suggested by the Postal Service as a means for solving Automation/Nonautomation data problem. However, as discussed in the next section, I have used a slightly different methodology to de-average the CRA-derived Presorted unit cost into Automation and Nonautomation. Table 3 compares my results to those of the CRA and the Postal Service. Like the Postal Service, my methodology derives a lower Nonautomation unit cost estimate compared to the CRA, but not nearly as low as the Postal Service's method.

[13] I have relied upon the analysis of Pitney Bowes witness Buc in making the specific cost pool classifications. See Library Reference PB-LR-L-1, Tab 5.

Table 3
Comparison of TY 2008 Unit Costs for
First-Class Automation and Nonautomation Letters
(PRC Attributable Costs, Cents)

First-Class Presort Category	CRA	USPS Model	MMA Model
Nonautomation	24.53	7.17	13.10
Automation	4.22	4.92	4.70
Combined	5.00	5.00	5.00

Sources: USPS-LR-147, USPS-LR-L-110, MMA-LR-1, p. 3

E. CRA Proportional Adjustment Factors

In general, the Postal Service's models are simply theoretical simulations of mail flow and, therefore, cannot exactly replicate the real world complexities of mail processing. To tie the model-derived unit costs to actual costs, CRA Proportional Adjustment factors are derived and used to reconcile the model-derived unit costs to an appropriate CRA-derived unit cost standard. As described by USPS witness Abdirahman, "[t]he purpose of the Proportional Adjustment factor is to bring the modeled costs into alignment with the CRA costs." Tr. 4/589.

In the past, CRA-derived unit processing costs have been available for MML (as a proxy for BMM[14]), Nonautomation letters and Automation letters. The relationship of the actual CRA-derived unit costs to model-derived unit costs provides insight regarding how well the models reflect actual costs and, ultimately, what specific adjustments must be made to the model results to bring them into alignment with the CRA.

After evaluating the model and CRA results for the past three rate cases, it is clear to me that the mail flow models' costs associated within the Remote Bar Code System (RBCS) are too low. I discussed this phenomenon more than four years ago in R2001-1. *See* KE-ST-1 pages 7 - 17. At the time I analyzed the

[14] In this discussion, I assume that the model-derived unit costs for BMM and MML are the same and use the terms interchangeably. USPS witness Abdirahman testified that the models for BMM and MML would be very similar if not identical. Tr. 4/656.

Postal Service's models and concluded (R2001-1, KE-ST-1, p. 9 (footnote omitted, emphasis in original)):

> Two distinctly different results occur depending upon whether or not First-Class letters are processed through the RBCS. When non-prebarcoded letters are sent through the RBCS, the model significantly ***understates*** costs. When letters bypass the RBCS, as prebarcoded QBRM letters do, the model significantly ***overstates*** costs. There can be no doubt that the RBCS costs, as reflected in the Postal Service's mail flow models, are problematic.

I have updated my analyses from R2001-1 and confirm, once again, that the Postal Service's mail flow models understate the actual processing costs of First Class letters that are not prebardoded. As shown in Library Reference MMA-LR-3, there are three comparisons of letter categories where I have modified the entry characteristics such that the letters either must be processed within the RBCS or can bypass the RBCS. The results are shown in Table 4. In each case, the results are unreasonable and contrary to expectation.

Table 4
Analysis of Model-Derived Unit Costs With and Without RBCS Processing (Cents)

Model	TY 2008 Model-Derived Unit Cost	Change In Unit Cost Due to Prebarcoding
1. BMM No Prebarcodes	5.183	
BMM With Prebarcodes	5.420	0.238
2. NAMMA No Prebarcodes	5.193	
NAMMA With Prebarcodes	5.432	0.239
3. MAADC No Prebarcodes, No Presort	5.193	
MAADC With Prebarcodes	5.163	(0.031)

Source: MMA-LR-3, p. 1

Since BMM is not prebarcoded, it normally enters the model at the outgoing RBCS operation "OUT ISS" which attempts to spray on a barcode. If the BMM letters are assumed to be prebarcoded and are adjusted to enter the model at the "Out Auto Prim" operation, processing costs should go ***down*** because they do not require extra processing in the RBCS operation. Instead, the Postal Service's model produces a derived unit cost that goes ***up*** by 0.238

cents. Thus, the mail flow model inexplicably indicates that it costs the Postal Service less to read an address and spray on a barcode than for the mailer to provide a prebarcode.

A similar, nonsensical result occurs with the Postal Service's model for Nonautomation Machinable MAADC-AADC (NAMMA) letters. As is the case with BMM, NAMMA is normally entered in the Postal Service's model at the "Out ISS" in order to obtain a barcode. However, if the Postal Service's NAMMA model is modified by assuming that NAMMA is prebarcoded, the entry point would be changed to the "Out Auto Primary" operation. The costs should go ***down***, but instead, go ***up*** by 0.239 cents.

With respect to prebarcoded Automation MAADC letters, the results are also unrealistic. When the presort level is reduced so that the letters cannot bypass the outgoing primary sort ***and*** the prebarcodes are removed, the unit costs should certainly go ***up significantly***. Not only does the Postal Service lose the benefits of presorting past the outgoing primary sort, but it also now has to apply a barcode. However, according to the Postal Service's mail flow model, the unit costs remain virtually the same, increasing by just .031 cents.

This updated analysis provides overwhelming evidence that the current models still understate RBCS costs, an issue that was pointed out more than four years ago. See R2001-1, KE-ST-1, p. 17, fn 15.

The purpose of applying CRA Proportional Adjustment Factors to the model-derived unit costs is to "bring the modeled costs into alignment with the CRA costs." Tr. 4/589. Such an adjustment, if done correctly, tends to correct for errors such as the models' understatement of RBCS costs. But USPS witness Abdirahman dismisses this entire issue by deriving one CRA Proportional Adjustment factor for all Presorted letters combined. By doing so, he is unable to account for the different predispositions exhibited by the models with respect to RBCS processing.

USPS witness Abdirahman incorrectly applies one CRA Proportional Adjustment factor for all Presorted letters combined. This "combined" CRA Proportional Adjustment factor does not allow his model results to be properly

adjusted. The CRA Adjustment factor needs to correct for the models' understatement of RBCS costs for letters requiring such processing and the models' overstatement of other processing costs for letters that bypass the RBCS. One CRA Proportional Adjustment factor alone cannot possibly perform both tasks simultaneously.

For example, Nonautomation letters require RBCS processing in the same manner as BMM. We know from past experience that the BMM model-derived unit costs have always been low compared to the BMM CRA-derived unit costs. Accordingly, it is likely that the model-derived unit cost for Nonautomation letters will also be low compared to actual costs. The opposite is true for Automation letters – the model-derived unit costs are historically high compared to the actual CRA costs. Using one CRA Proportional Adjustment factor for all presorted letters combined fails to correct for this problem.

Mr. Abdirahman's use of one CRA Proportional Adjustment factor for all Presorted letters (Automation and Nonautomation combined) is inappropriate and produces inaccurate unit cost estimates. His derived CRA Proportional Adjustment factor is 1.013. *See* Library Reference USPS-LR-L-48, p. 2. This means he increases his model-derived unit costs for each category within Nonautomation and Automation letters by 1.3% in order to reconcile his models to the CRA. Based on the consistent past behavior of his models, which required increasing the model-derived unit cost for Nonautomation letters and reducing the model-derived unit cost for Automation letters, Mr. Abdirahman should have recognized that applying one CRA Proportional factor would produce final unit costs that are inaccurate – too low for Nonautomation letters and too high for Automation letters.

The simple logic that I have applied is as follows. The Postal Service has confirmed that BMM and NAMMA letters exhibit very similar costs attributes. Tr. ____. (Response to MMA/USPS-T22-35 (B)) In fact, the mail flow models used to simulate BMM and NAMMA processing are identical.[15] Further, the Postal Service agrees that the BMM model understates the CRA-derived unit cost standard by 2.915 cents or 36%. Tr. ____. (Response to USPS/MMA-T22-32 (A)) I contend that, if the BMM model understates actual costs by 36% and BMM and NAMMA costs are very similar, then it is reasonable to conclude that the NAMMA model also understates actual costs by 36 percent.[16]

The final proof is in the numbers. Table 5 compares NAMMA and BMM unit costs using the Postal Service's single CRA Proportional Adjustment factor with the unit costs I develop using separate CRA Proportional Adjustment factors for NAMMA and BMM.[17]

Table 5
Comparison of NAMMA and BMM Model-Derived Unit Costs
(PRC Attributable Costs, Cents)

	TY 2008 Model-Derived Unit Cost	
First-Class Letter Category	**USPS**	**MMA**
NAMMA	5.42	8.12
BMM	8.11	8.11
Sources:	USPS-LR-L-110 USPS-LR-L-141	MMA-LR-I

[15] See Tr. ____. (Response to MMA/USPS-T22-35 (A) The model-derived unit costs of BMM and NAMMA are identical except for the tiny difference in the premium pay factors applied separately for single piece letters and presorted letters. *See* Library Reference USPS-LR-L-141, p. 3 for BMM and USPS-LR-L-110, p. 14 for NAMMA.

[16] The Postal Service disagrees with this logic. When asked if it was likely that the NAMMA model would understate costs in the same manner as the BMM model, the Postal Service simply points out that "[t]he cost models could overstate, understate cost or accurately state costs, given that they are used as an estimation tool." Tr. ___. (Response to MMA/USPS-T22-35 (D)) In another answer to the same question the Postal Service points out that "[t]he Nonautomation letters introduce additional issues that do not concern BMM." Tr. ___. (Response to MMA/USPS-T-23 (E)) Neither of these answers is responsive or convincing.

[17] This comparison uses the Postal Service's methodology but the Commission's attributable costs to make an "apples-to-apples" comparison.

My results show that NAMMA and BMM unit costs are similar, as expected. In contrast, the Postal Service's results indicate that the unit cost for BMM (8.12 cents) is **50% higher** than the unit cost for NAMMA (5.42 cents).[18]

The Postal Service's unit costs for NAMMA and BMM letters are so different because the Postal Service ignores the fact that its model fails to account for 36% or 2.915 cents of costs that BMM incurs, according to the CRA. Knowing that the BMM model fails to pick up 2.915 cents worth of costs, it is reasonable to expect that the model for very similar letters, i.e. NAMMA letters, would also fail to pick up those same costs. Taking this logic one step further, it seems clear that Nonautomation 3-digit and 5-digt letters would also require the same steps in order to "bring the modeled costs into alignment with the CRA costs." Such mail must be processed within the incoming RBCS and a similar adjustment to the model-derived understatement of RBCS costs is necessary.

I have corrected Mr. Abdirahman's flawed use of one CRA Proportional Adjustment factor that he applies to all his models by using two separate CRA Proportional Adjustment factors: one for Nonautomation letters and a separate factor for Automation letters. As Table 5 demonstrates, my results are much more reasonable and consistent with past information.

To de-average Presorted costs into Nonautomation and Automation, I first derive a CRA Proportional Adjustment factor for MML which, like Nonautomation letters, requires processing in the RBCS operation. Because the MML CRA-derived unit cost is 56% higher than the model-derived unit cost, a CRA Proportional Adjustment factor of 1.56 must be applied to bring the model costs in line with CRA costs. Since Nonautomation letters are so similar to MML letters, I increased the Nonautomation model-derived unit costs using the same

[18] The Postal Service's confirmation that "NAMMA and BMM exhibit similar physical characteristics and would be expected to have similar cost characteristics." Tr. ____. (Response to MMA/USPS-T32-35 (B)) refutes the notion that the unit cost of BMM is 50% higher than that of NAMMA letters.

CRA Proportional Adjustment factor.[19] Then, by using the CRA-derived unit costs for all Presorted letters, I "backed out" Nonautomation costs from Presort costs and derived a separate CRA Proportional Adjustment factor of 0.93 for Automation letters. See Library Reference MMA-LR-1, p. 3**.** This result is consistent with past experience since the Postal Service's Automation models have always overstated CRA costs.[20]

F. Delivery Point Sequence Percentages

Delivery point sequence percentages (DPS %s) for each letter category are by-products of the Postal Service's mail flow models. The method used to derive the DPS %s from the models is precisely the same as that used in the last three rate cases. In this regard, I note that, as reflected by the theoretical mail flows within each of the Automation letter models, the probability that a letter will be processed by automation throughout the mailstream varies with the degree of presort. Table 6 shows the automation probability by presort category.

[19] The Postal Service substituted the BMM CRA Proportional Adjustment factor for the Nonautomation CRA Proportional Adjustment factor used for deriving QBRM savings. *See* Tr. ___. (Response to TW/USPS-6) I too have assumed that the BMM and Nonautomation CRA Proportional Adjustment factors would be very similar. USPS witness Abdirahman's application of a totally different CRA Proportional Adjustment factor to Nonautomation model results in Library Reference USPS-LR-L-48 is inconsistent with the assumption that the BMM and Nonautomation CRA Proportional Adjustment factors are very similar.

[20] While this is consistent with past experience, the CRA Proportional Adjustment factor is slightly higher than experienced in previous cases. The reason for this phenomenon is not improvements in the model to lower the theoretical costs but rather the fact that the CRA-derived unit cost for Automation letters is significantly higher than in the past. The Postal Service has confirmed that it made no material changes to the models. Input parameters have simply been updated. Tr. ___. (Response to MMA/USPS-T22-42) First-Class workshared letter "proportional costs" have seen an 11.3% increase from "comparable" test year costs projected just one year earlier. Apparently, the method used to collect and assign IOCS tallies significantly increased workshared letter costs compared to other First-Class categories. Tr. ___. (Responses to MMA/USPS-16(C), MMA/USPS-T22-28(D)) Thus, the CRA-derived unit costs are much higher than reported in the past, which explains why they are closer to the model-derived unit cost in this case than they were in previous cases.

Table 6
Probabilities for Automation Processing Through Delivery
For Automation Letters

Automation Rate Category	Automation Probability
MAADC	88.4%
AADC	91.1%
3-Digit	92.4%
5-Digit	95.6%

Sources: USPS-LR-L-48
Tr. 4/592

As Table 6 demonstrates, the likelihood that Automation mail can be successfully processed with automation increases with the degree to which the mail pieces are presorted. The converse is also true: the lower the degree of presortation, the greater the probability that the letters will require manual processing. While the Postal Service has abandoned its decade-long position that DPS %s vary with presort level, I have continued the practice of using the models to estimate the DPS %s. However, in order to recognize the independent DPS %s provided by USPS witness Kelley, I reconciled the model-derived DPS %s to the new data in much the same manner as the model-derived processing unit costs have been reconciled to actual CRA costs. This is discussed further in Section II.D below.

G. Summary of Mail Processing Cost Savings Results

The final derived workshared mail processing unit cost savings by presort rate category are provided in Table 7.

Table 7
MMA Derived TY 2008 Workshared Cost Savings by Presort Category
(Cents)

	Mail Processing Unit Costs			
First-Class Letter Rate Category	**Benchmark**	**Presorted Letters**	**Total Unit Cost Savings**	**Incremental Unit Cost Savings**
Metered Mail	13.13			
Nonautomation		13.10	0.03	0.03
Mixed AADC		7.72	5.41	5.39
AADC		5.94	7.19	1.78
3-Digit		5.32	7.81	0.62
5-Digit		3.30	9.82	2.02

Source: MMA-LR-1, p. 1

II. Derivation Of Delivery Cost Savings

Delivery operations represent a second major area where worksharing generates significant cost savings. My analyses show that worksharing significantly reduces delivery costs by almost 4 cents per piece on average per delivered piece, and by more than 3 cents per originating piece.

In order to estimate delivery cost savings due to worksharing, it is necessary to estimate unit delivery costs for each presort level and then compare them to a nonworkshared letter-shaped benchmark. In doing so, I have relied on the Postal Service's delivery cost study that derives unit costs by shape. In order to utilize these results to properly measure workshared cost savings, I have made modifications in the following areas:

A. Removal of Collection Costs
B. De-averaging Single Piece Letter Delivery Costs
C. Delivery Cost Benchmark
D. De-averaging Automation Delivery Costs
E. Derivation of Costs Per Delivered Letter

A. Removal Of Collection Costs

When the city delivery cost collection systems were revamped after R2001-1, one of the biggest changes concerned collection costs, which increased by about four times. Since collection costs have little to do with

delivery costs, it is necessary to remove them. USPS witness Kelley provided me with the relevant data to remove collection costs. *See* Tr. 12/3360-62. A summary of this analysis is shown in Table 8.

Table 8
Collection Cost Removal from First-Class Single Piece Delivery Costs

First-Class Single Piece Letters	Total Delivery Costs ($000)	Unit Cost Per Delivered Letter (Cents)
With Collection Costs	2,675,500	12.64
Without Collection Costs	1,782,394	8.42
Collection Costs	893,106	

Source: MMA-LR-2, p. 3

B. De-averaging Single Piece Letter Delivery Costs

My initial objective was to derive unit delivery costs for MML that could be used as the benchmark from which to measure workshared delivery cost savings. MML represents “clean” nonworkshared letters which should provide a good indication of the difference in costs incurred to deliver a letter without worksharing versus a letter with worksharing. Using MML as the benchmark would also be consistent with the mail processing cost savings analysis. USPS witness Kelley provided the delivery costs separately for stamped, metered and “other” letters. Tr. 12/3352-54. Using that information, I de-averaged the unit delivery cost of 8.42 cents for all single piece letters (without collection costs) shown in Table 8 into the three indicia categories. The results are shown in Table 9.

Table 9
TY 2008 First-Class Single Piece Delivery Costs De-Averaged
(Cents)

First-Class Single Piece Category	Unit Cost Per Delivered Letter
Stamped	8.32
Metered	8.61
Other	8.25
All Single Piece	8.42

Source: MMA-LR-2, p. 4

C. Delivery Cost Benchmark

In this case, I wanted to use MML costs without collection costs as the appropriate delivery cost benchmark. However, as shown in Table 9 above, the unit delivery cost per delivered letter for MML (8.61 cents) is higher than for both stamped letters (8.32 cents) and "other" letters (8.25 cents). These results surprised me. Accordingly, I elected to use a benchmark with a lower unit delivery cost (8.42 cents) -- all single piece letters combined -- from which to derive workshared delivery cost savings. While such a benchmark is conservative in that the unit cost for all single piece letters is lower than for MML, it also is conceptually reasonable. Using the cost differences between all single piece letters and each workshared category has appeal because it measures the true difference in all delivery cost attributes that differentiate single piece from presort letters.

D. De-averaging Automation Delivery Costs

For Automation letters, a similar de-averaging process is required since the Postal Service fails to provide individual unit delivery costs for each Automation presort level. To accomplish this, DPS %s are used as a cost driver of in-office costs in much the same way that the Postal Service de-averaged delivery costs in R2005-1. The DPS %s are derived from the mail flow models and then reconciled to the DPS %s reported by USPS witness Kelley from the

carrier data systems. The results from this analysis, including the resulting unit delivery costs by presort level, are shown in Table 10.

Table 10
TY 2008 Automation Letter Costs De-Averaged
(Cents)

First-Class Presort Category	Model Derived DPS %s	Reconciled DPS %s	TY 2008 Unit Delivery Cost Per Delivered Letter
Nonautomation	82.58%	77.22%	5.24
Mixed AADC	80.07%	80.76%	4.97
AADC	82.54%	83.24%	4.78
3-Digit Letters	83.65%	84.36%	4.69
5-Digit Letters	86.60%	87.33%	4.46
CR Letters	86.60%	87.33%	4.46
Total Automation	84.52%	85.24%	4.63
Total Presort Letters	84.45%	84.95%	4.65

Source: MMA-LR-1, p. 2, MMA-LR-2, p. 1

E. Derivation of Delivery Costs Per Delivered Letter

Derivation of unit delivery costs per ***delivered*** letter is not a new concept but has never been adequately addressed by the Commission. Therefore, I will provide a detailed explanation of this issue.

The Postal Service calculates unit delivery costs per ***originating*** letter. If the percentage of pieces actually delivered by carriers were the same for single piece letters and workshared letters, using the Postal Service's delivery costs per originating letter would be fine. The problem is that the percentage of First-Class single piece letters that are actually delivered by city and rural carriers (61%) is much lower than the percentage of workshared letters that are actually delivered by city and rural carriers (90%). Under these circumstances, derivation of delivery costs per originating piece, by themselves, makes little sense. A simple example discussed at Tr. 12/3392 illustrates this point.

Assume that there are two categories of letters: Category A has a unit delivery cost per originating letter of 5 cents and Category B has a unit delivery cost per originating letter of 7 cents. One might suspect that it costs 2 cents

more to deliver a Category B letter. However, the unit delivery costs per originating letter do not provide sufficient information to make that conclusion.

Assume further that 60% of Category A letters are actually delivered by city and rural carriers while 90% of Category B letters are actually delivered. Using this additional information, the unit cost to actually deliver a Category A letter becomes 8.3 cents while the unit delivery cost for a Category B letter is 7.8 cents. In other words, a Category B letter costs 0.5 cents less to deliver than a Category A letter.

When comparing unit delivery costs for two letter categories with ***different*** proportions that are actually delivered by carriers, it is necessary to derive the unit cost per ***delivered*** letter.

Comparing the unit cost differences per ***delivered*** letter between presorted and single piece letters derives a cost savings. However, such savings accrue only if a particular letter is actually delivered. If a letter bypasses the delivery system, i.e., is addressed to a post office box, no delivery cost savings will accrue. Consequently, it is necessary to adjust the derived cost savings per *delivered* letter and spread these savings over all ***originating*** letters, as shown in Table 11.

Table 11
Derivation of TY 2008 Presort Delivery Cost Savings
(Cents)

First-Class Letter Rate Category	TY 2008 Unit Costs Per Delivered Letter	TY Unit Delivery Savings Per Delivered Letter	% Of TY Letters Delivered by Carriers	TY Unit Delivery Savings Spread Over All Letters
Single Piece Benchmark	8.42			
Nonautomation	5.24	3.18	89.60%	2.85
MAADC	4.97	3.45	89.60%	3.09
AADC	4.78	3.64	89.60%	3.26
3-Digit	4.69	3.73	89.60%	3.34
5-Digit	4.46	3.96	89.60%	3.54
Automation	4.63	3.80	89.60%	3.40
Presorted	4.65	3.77	89.60%	3.38

Source: MMA-LR-2, p. 1

III. Total Workshared Cost Savings

The final step to derive total workshared cost savings is to combine the mail processing cost savings shown in Table 7 with the delivery cost savings shown in Table 11. The results are shown in Table 12.

Table 12
TY 2008 Total Worksharing Unit Cost Savings
(Cents)

First-Class Letter Rate Category	Benchmark	Mail Processing + Delivery Unit Cost	Total Workshared Unit Cost Savings
Benchmark	20.67		
Nonautomation		17.80	2.88
Mixed AADC		12.17	8.50
AADC		10.22	10.45
3-Digit		9.53	11.15
5-Digit		7.30	13.37

Source: MMA-LR-1, p. 1

Appendix II
Technical Discussion: High Volume QBRM Cost Issues

There are two rate components that High Volume QBRM recipients pay based on the number of pieces received: a discounted First-Class basic rate and a QBRM per piece fee that is paid in addition to the QBRM rate. The cost aspects of each of these rate elements are discussed below:

I. QBRM Cost Savings

There are two major problems with the manner in which the Postal Service has derived QBRM cost savings. First, its proposal to limit the mail flow model arbitrarily ignores substantial cost savings that accrue downstream after the first outgoing barcode sortation. Second, the Postal Service assumes, incorrectly, that the QBRM model-derived unit cost must be adjusted to reflect the model's failure to pick up 36 percent of actual cost for letters requiring processing within the Remote Bar Code System (RBCS). QBRM completely bypasses the RBCS.

A. Model Design

In order to derive cost savings arising from the special attributes of QBRM, the mail processing costs incurred by prebarcoded QBRM are compared with the costs incurred by hand-addressed (HAND) letters. The costs for these two types of mail are developed from separate mail flow models for each.

In this proceeding, the Postal Service proposes to limit derived QBRM cost savings by producing a "narrowly defined cost analysis" that eliminates from consideration any costs that QBRM saves after the first barcoded sortation. *See* USPS-T-22, p. 16. The Postal Service's proposal to limit QBRM cost savings represents an unjustified departure from the cost savings methodology employed by the Postal Service and relied upon by the Commission in R2000-1.[1]

The automation compatible features of QBRM make for a much higher probability that QBRM letters will be processed by automation until delivery. The

[1] The Postal Service made the same proposal in R2001-1 and R2005-1 but the Commission made no merits determination on this proposal because both proceedings were settled.

same cannot be said for HAND letters which are much more apt to be processed manually before reaching delivery.

QBRM and HAND letters cannot be processed identically after the first barcode sort. More specifically, since, according to the Postal Service's mail flow models, more than twice as many HAND letters are rejected in the first barcode sortation, a larger portion of HAND letters require expensive manual processing thereafter. Therefore, the Postal Service's methodology denies QBRM credit for substantial cost savings that accrue after that initial sort where the Postal Service's model stops measuring cost savings.

Table 1 shows the percentages of QBRM and HAND letters that are rejected during the first barcoded sort, as shown in the Postal Service's mail flow models and confirmed by USPS witness Abdirahman.[2]

Table 1
Comparison of Manual/Automated Pieces that Remain After the First Barcoded Sort Between HAND and QBRM Letters

Type of First-Class Letter	% Rejected During the First Barcoded Sort
HAND	9.72%
QBRM	4.24%

Source: USPS-LR-L-69, "BRM"

Manual processing costs are approximately 13 times the cost of automated processing. *See* USPS-T-42, p. 12. Because almost 10% of HAND letters require very expensive manual processing after the first barcode sort while only 4.24% of QBRM letters require manual processing, the Postal Service's proposal to stop counting cost savings from this point on ignores substantial savings enjoyed by QBRM compared to HAND letters.

Before application of the CRA Proportional Adjustment factors -- to tie the model-derived unit costs to actual costs -- the Postal Service's derived cost savings between QBRM and HAND letters is only 1.03 cents. (*See* Library

[2] Library Reference USPS-LR-L-69; Tr. 4/561.

References USPS-LR-L-69 and USPS-LR-L-104. By contrast, the comparable figure, which takes into account savings that accrue after the first barcoded sort, is 2.65 cents. *See* Tr. ____. (Response to TW/USPS-6 (B)) Accordingly, the Postal Service's "narrow" view for measuring the model-derived unit cost savings is low by 1.62 cents or 61%.

B. CRA Proportional Adjustment Factors

Once the model-derived unit costs are correctly computed for HAND and QBRM letters, appropriate CRA Proportional Adjustment factors are applied to the unit costs to reconcile the model-derived unit costs to actual CRA costs. However, a problem arises because there are no CRA unit costs for either QBRM or HAND letters.

The Postal Service applies the CRA Proportional Adjustment factor derived for BMM letters to the unit costs of ***both*** QBRM and HAND.[3] Multiplying the QBRM and HAND model-derived unit costs by the 1.564 CRA Proportional Adjustment factor raises each by the same 56.4 percentage.

While the logic of applying a CRA Proportional Adjustment factor to the model-derived unit costs is sound, the Postal Service erred by applying the same factor to the unit costs of both QBRM and HAND letters. First, as a reference point, I agree with the Postal Service's choice of the BMM Proportional Adjustment factor for HAND letters. The CRA cost target for BMM letters is 56.4% higher than unit cost produced by the BMM model. That means that the mail flow model fails to reflect a substantial amount of actual costs incurred to process this mail. Since HAND letters and BMM letters are similar (in that both require processing through the RBCS) it is reasonable to assume that the model-derived unit cost for HAND letters is similarly understated. Raising the modeled-derived unit cost for HAND letters by applying the BMM CRA Proportional

[3] It appears that the Postal Service uses the BMM CRA Proportional Adjustment factor as a proxy for the Nonautomation CRA Proportional Adjustment factor. *See* Tr. ___. (Response to TW/USPS-6 (B). This is consistent with my cost analysis but inconsistent with USPS witness Abdirahman's method for de-averaging Presorted costs into Automation costs and Nonautomation costs. See Library Reference USPS-LR-L-48, p. 2.

Adjustment factor brings the model-derived unit cost "into alignment" with the CRA. Tr. 4/589.

I do ***not*** agree with the Postal Service's use of the BMM CRA Proportional Adjustment factor to "true up" the model-derived unit cost for QBRM letters. QBRM letters completely bypass the RBCS because the FIM mark is used to cull QBRM letters from other single piece letters before they are sent to the RBCS, and all QBRM letters have a pre-approved, high quality barcode printed on the letter. QBRM letters are routed directly to an automated outgoing primary barcode sortation.

As discussed in greater detail in Appendix I and as demonstrated in Library Reference MMA-LR-3, the Postal Service's mail flow models historically understate costs for letters requiring RBCS processing and overstate costs for letters that bypass the RBCS. Since QBRM bypasses the RBCS, it is counter intuitive to apply a CRA Proportional Adjustment factor that increases the model-derived unit cost by 56.4% for QBRM as the Postal Service does. QBRM exhibits cost attributes that are distinctly different than either BMM or HAND.[4] Accordingly, there is no reason to believe that the QBRM model has understated processing unit costs in the same manner as the BMM or HAND models have.

QBRM letters share the same cost causing attributes as Automation letters. Both types of letters are prebarcoded and meet stringent automation compatibility requirements. Therefore, QBRM letters and Automation letters both bypass the RBCS operation. Tr. 4/563. Accordingly, I have applied the CRA Proportional Adjustment factor of 0.931 derived for Automation letters to the

[4] USPS witness Abdirahman suggests that it is appropriate to use the BMM CRA Proportional Adjustment factor for both HAND and QBRM "because all three mail types are components of the First-Class Single-Piece mail stream." Tr. 4/563-4. While this statement is factual, I question its relevance. Because the Postal Service requires QBRM letters to be pre-approved and to bear a FIM and a prebarcode, which makes them automation-compatible, QBRM letters are far closer to Automation letters than to single piece letters. Tr. 4/563. The purpose of applying the BMM CRA Proportional Adjustment factor to the model-derived cost of HAND letters is to correct for the fact that the model understates RBCS costs. It makes no sense to apply the same CRA Proportional Adjustment factor to the model-derived unit cost for QBRM because QBRM completely ***bypasses*** the RBCS.

QBRM unit cost of 4.122 cents. This brings the QBRM model-derived unit cost "into alignment" with the CRA for QBRM.

Table 2 shows how I derived QBRM cost savings.

Table 2
MMA Derivation of QBRM Unit Cost Savings
(Cents)

	(1)	(2)	(3)
Type of First-Class Letter	**Model-Derived Unit Cost**	**CRA Proportional Adj Factor**	**Reconciled Unit Cost**
			(1) x (2)
HAND	6.768	1.564	10.589
QBRM	4.122	0.931	3.838
Difference			6.751

Sources: Response to TW/USPS-6B, MMA-LR-1, pages 3 and 5

The 6.75 cents QBRM cost savings I derive is more than 5 cents higher than the cost savings shown by the Postal Service (1.49 cents).

As a test of reasonableness, I compared the HAND and QBRM results shown in Table 2 to costs for similar letters for which adjusted model-derived, reconciled unit costs are also available. To accomplish this I initially modified the QBRM model to reflect the exact same densities, miscellaneous factors and accept rates exhibited for other First-Class categories. This enables me to make an "apples to apples" comparison by removing any exogenous factors.

My expectation was that HAND letters should cost slightly more than metered mail letters (MML) and QBRM letters should cost slightly more than Automation Mixed AADC (MAADC) letters. The reasons for my expectations are as follows. HAND and MML are very similar, except that HAND has a higher reject rate than MLL because HAND letters contain hand-addressed envelopes whereas a substantial portion of MLL letters have typewritten addresses that are more machine readable. QBRM and MAADC letters are very similar, except that QBRM is assumed to be entered in the model's "Out Auto Primary" operation whereas MAADC is entered in the "Out Auto Sec" operation.

The results of my test analysis are shown in Table 3. As expected, the unit cost for HAND letters is higher than the unit cost for MML, reflecting the additional costs required to process more letters manually. As also expected, QBRM letters cost slightly more than MAADC, reflecting the fact that QBRM enters the processing stream earlier and requires additional processing.

Table 3
Comparison of TY 2008 Model-Derived and Reconciled Unit Costs
(Cents)

	(1)	(2)	(3)
Type of First-Class Letter	**Model-Derived Unit Cost**	**CRA Proportional Adj Factor**	**Reconciled Unit Cost**
			(1) x (2)
MAADC	5.163	0.931	4.807
QBRM	5.432	0.931	5.058
MML	5.183	1.564	8.108
HAND	6.574	1.564	10.285

Sources: MMA-WP-2, MMA-LR-1, pages 3, 5 and 8

As one final test, I applied the BMM Proportional Adjustment Factor to the QBRM model-derived unit cost, just as the Postal Service has done. The resulting reconciled cost would have been 5.432 x 1.564 or 8.499 cents. This would cause QBRM to cost more than MML to process, a highly unlikely situation. Accordingly, the Postal Service's erroneous application of the BMM Proportional Adjustment Factor to the QBRM model-derived unit cost should be rejected.

II. High Volume QBRM Per Piece Costs

The per piece costs for High Volume QBRM reflect the counting of such pieces so that the postage can be determined and collected. As discussed in my direct testimony, the BRM Practices Study contained in Library Reference LR-USPS-L-34 suffers from the same infirmities as the 1997 BRM Practices Study. In brief, it produces results that are demonstrably unreasonable as they relate to manual counting for High Volume QBRM. The flawed finding in the 1997 BRM

Practices Study that 46% of High Volume QBRM was manually counted has been repudiated twice, first by USPS witness Campbell in R2000-1 and again by USPS witness Miller in R2001-1. Mr. Campbell conducted a survey of the top 77 High Volume QBRM recipients and determined that only 11% of high volume QBRM was counted manually. Mr. Miller did a more comprehensive survey of the top 151 QBRM High Volume recipients, which showed that less than 0.4% of this QBRM was hand counted.[5] Moreover, as the Commission agreed, it is simply "strains credulity" to think that the Postal Service could possibly hand count so many pieces received in high volumes. (R2000-1 PRC Opinion at 552)

To compute the unit cost for the High Volume QBRM per piece fee, I employ two methodologies. First, I use the results found by USPS witness Loetscher's BRM Practices Study in this case, except that I have assumed the productivity for counting machines or weight averaging techniques instead of the very low and inefficient productivity for manual counting. Second, I assume the counting methods by percentage found by USPS witness Miller's comprehensive survey of 151 High Volume QBRM recipients conducted for R2001-1 and utilized by USPS witness Hatcher in R2005-1.

In both derivations, I have also assumed a zero cost for counting QBRM that is processed by BRMAS software. This is consistent with the Postal Commission's treatment in R2000-1.

Tables 4 and 5 provide the derivation of the unit cost to count High Volume QBRM using both assumptions. As these tables show, the per piece fee cost ranges from 0.012 cents to 0.070 cents. Of the two unit costs, I think that 0.012 cents is more reliable. It incorporates the counting method percentages based on the comprehensive survey of actual counting methods, rather than

[5] USPS witness Loetscher who sponsors the new BRM Practices Study in this case confirmed that he did not know anything about the High Volume QBRM counting methods survey conducted by USPS witness Campbell in R2000-1 or the Commission's Recommended Decision in that case. Tr. 7/1575-76. Mr. Loetscher also testified that he only reviewed the more comprehensive survey conducted by USPS witness Miller in R2001-1 (Tr. 7/1580-1582) a "couple days" before taking the witness stand in this case. Tr. 7/1576-77.

relying upon a statistical probability sampling of offices that must be expanded to represent the entire universe of High Volume QBRM counting.

Table 4
Derivation of High Volume QBRM Unit Counting Costs
Using R2006-1 Counting Method Percentages
(Cents)

Counting Method	Volume %	PPH	Wage Rate	Direct Cents Per Piece	Piggy back Factor	Prem Pay Factor	Prem Pay Adjustment	Total Cents Per Piece	Weighted Cents Per Piece
R2006-1 Percentages:									
Other Software	0.00%	---	---	---	---	---	---	---	---
BRMAS 1/	3.40%	---	---	---	---	---	---	---	---
End-of-Run (EOR)	45.40%	---	---	---	---	---	---	---	---
Counting Machine	10.00%	37,145	37.992	0.102	1.333	1.012	0.001	0.138	0.014
Manual 2/	26.60%	37,145	37.992	0.102	1.333	1.012	0.001	0.138	0.037
Weight Averaging	14.60%	37,145	37.992	0.102	1.333	1.012	0.001	0.138	0.020
Total	100.00%								0.070

Source: USPS-LR-L-104
1/ Assumes No Counting Cost per R2000-1 PRC Opinion
2/ Assumes Productivity for Counting Machine or Weight Averaging

Table 5
Derivation of High Volume QBRM Unit Counting Costs
Using R2005-1 Counting Method Percentages
(Cents)

Counting Method	Volume %	PPH	Wage Rate	Direct Cents Per Piece	Piggy back Factor	Prem Pay Factor	Prem Pay Adjustment	Total Cents Per Piece	Weighted Cents Per Piece
R2005-1 Percentages:									
Other Software	16.46%	---	---	---	---	---	---	---	---
BRMAS 1/	49.35%	---	---	---	---	---	---	---	---
End-of-Run (EOR)	30.17%	---	---	---	---	---	---	---	---
Counting Machine	1.19%	37,145	37.992	0.102	1.333	1.012	0.001	0.138	0.002
Manual	0.38%	2,932	37.992	1.296	1.333	1.012	0.015	1.743	0.007
Weight Averaging	2.45%	37,145	37.992	0.102	1.333	1.012	0.001	0.138	0.003
Total	100.00%								0.012

Sources: Tr. 7/1582, R2005-1 USPS-LR-K-104
1/ Assumes No Counting Cost per R2000-1 PRC Opinion